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TRANSCRIPT

Why Tax Diversity is Key to Europe's Competitiveness

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Mr Chairman
Honourable Members
Excellencies
Ladies and Gentlemen,

It's a pleasure and honour to be here and share with you some thoughts on tax diversity, tax centralization and European competitiveness as a European from the non-EU realm, and I thank our host and the organizers for their invitation to speak on this most pressing issue.

The talk in Europe's chancelleries these days, as Dr Rübig reminded us, is all about clamping down on citizens seeking to protect their wealth in more amicable environments. One of the most visible measures is of course the German secret service's recent purchase of stolen data of a Liechtenstein bank. However, not everybody sees it as a problem. Peer Steinbrück, Germany's finance minister, described it as "the deal of my life".

It is an unpleasant yet hardly questionable truth: most European governments today face huge challenges in the financing of their excessive welfare states further weakened by unfavourable demographics. At the same time, the electoral costs of fiscal consolidation are proving strong disincentives for many politicians to act. Their craving for more revenue leads to the current trend toward tax centralization and the ongoing pressure on so-called tax havens.

These efforts are supposed to prevent European taxpayers from seeking more amicable environments elsewhere and keep the tax bases more or less intact. Should this approach intensify, however, I'm afraid it will lead to massive capital flight out of Europe. Surely I don't need to mention Asia, and there are places nearer to us, such as Dubai, which are rapidly growing thanks to European investment and only charge user fees for "public services".

Let's not forget that European citizens are also increasingly escaping the state from within its borders. In Germany, the underground economy is estimated to have grown to 14.7 percent of GDP last year following the largest tax increase implemented since the end of the Second World War.

"Fair Competition"

One of the most persistent myths in favour of tax centralization, regulatory standardization or minimal tax rates relies on the idea of competition based on "fair" rules of the game or a "level playing field": businesses active in a given market should, according to this principle, all benefit from the same conditions of production.

In real life, however, competition depends precisely on competitors' differentiation, and all the more when competition is extended to the European or world level thanks to trade liberalization. It is up to the entrepreneur to best use both his own capacities and his environment, including the tax environment, to be more competitive with others.

If we followed through the logic of "fair competition", a large number of other differences would also have to be standardized, equalized and leveled out. This incongruity has been ridiculed with the analogy with the "unfair" advantage that Spanish tomato producers enjoy compared to their Dutch counterparts, the Spaniards unfairly benefiting from more free sunshine. Following the logic of "fair competition", then, the Spanish producers should be forced to cover their tomatoes with a canvas sheet, to equalize conditions with their northern competitors.

In the real world, there can of course never be a situation in which entrepreneurs are faced with the same production costs, if only for the natural differences between individuals. And Dutch tomato producers have developed other, innovative methods of production. Without this diversity of human intelligence, there would be no need for trade, since everyone would produce the same goods.

It is also because of these differences that innovation, differentiation, specialization, and the division of labor – all opposed to the homogenization implied by the fantasy of "fair competition" – are unavoidable characteristics of free trade.

Of course, local and national tax policies do create a large number of distortions and discriminations for businesses. Progressive taxation, for instance, penalizes especially effort and success. Taxes on wealth and capital delay the accumulation of capital and slow down innovation and the production of goods and services that would better fulfill, and at a lesser cost, consumers' needs.

But all these consequences are inherent to taxation and to standardize them would only extend their negative effects, which appears as the implicit reasoning behind the idea of "fair competition": the goal is foremost to raise the costs of businesses in other countries to make them less competitive, instead of seeking to make the local or national tax framework more attractive. This strategy of raising rivals' costs is apparent in the current dispute between the European Commission and Switzerland, for example. The "fair competition" promoted through tax standardization is little more than a form of protectionism.

"Public Goods" Financing

Another argument in favour of tax centralization suggests that because of capital flight – or taxpayer flight – to more attractive jurisdictions it would no longer be possible to finance so-called "public goods" and the redistributive policies to which Europe has become accustomed.

This point of view suffers from two major problems: first, it presupposes that the financing of a maximum of "public goods" is a good thing in itself; second, it suggests that taxation is the only decisive factor in the choice of residence or investment, a notion that is clearly refuted by relevant research. Most importantly, nothing suggests that those "public goods" really desired by consumers would not be produced, so long as people value them sufficiently to finance them on a voluntary basis through the market.

But the most striking weakness of the conventional analyses of "public goods" is that they consider only the positive effects of state expenditures. The production of "public goods" – as we know from the public choice school – often depends on incentives to give favours to organized interest groups and other rent seekers, to the detriment of all taxpayers.

From the perspective of facilitating such practices and bypassing any reappraisal of the EU's welfare states, tax centralization at the European level can indeed appear as a godsend. For the competitiveness of Europe, however, it would be a disaster.

"Market Efficiency"

Another argument in favour of tax standardization is the pretence that markets could function much more efficiently in a homogeneous tax environment. Conformity costs and economic distortions would thereby be reduced to a certain extent. This is the reasoning behind the current "common consolidated corporate tax base" project which the French government intends to push during its presidency in the second half of the year. Many multinational corporations also yield for understandable reasons to the appeal of this line of argument.

And yet, this point of view focuses only on the costs of diversity and completely ignores the impact of institutional competition between jurisdictions. While it appears true at first glance that the suppression of diversity could lower costs, at the same time it sets in motion a monopoly process, whose effects are well known. The comparison of different policies, the emulation of best practices, institutional innovation and incentives to more budgetary discipline are all shattered. Let's remember that the finance minister of Europe's largest country has already called for an EU-wide minimal corporate income tax rate of 30 percent.

Experience shows on the contrary that tax diversity and the use of "tax havens" by multinational corporations for their legal structures significantly enhance market efficiency. They promote investment and the growth of capital and help avoid some unfortunate side-effects of tax systems, such as overtaxation of capital or multiple taxation of the same profits within one group.

In this context "tax havens" serve at most as a channel for capital often used eventually to finance direct investment in the EU countries themselves. These efficiency gains in the international capital markets also encourage businesses to more efficiency in the allocation of their resources.

The process of tax centralization is driving Europe ever further from the four freedoms of the Treaty of Rome of 1957. And I dare say it is against the European idea.

It is not banal to remember ourselves that Europe owes its historical success precisely to its openness, diversity and dispersion of political power. The competition of political systems and the absence of centralization were decisive factors for the Renaissance, the Enlightenment, the Industrial Revolution and the great prosperity that followed. After the fall of Rome, Europe's political diversity allowed productive individuals to "vote with their feet", taking their capital with them.

With the division of authority, political protest could develop, leading to the emergence of parliaments and free cities, limiting predatory taxation and sparking similar progress in other places later on.

The current efforts to centralize taxation in Europe should therefore be recognized as opposed to the four freedoms laid out in the Treaty of Rome and as really against Europe's interests, against the European idea, and contrary to the conditions of Europe's exceptional success.

What is at stake today is nothing less than the preservation and increase of productive capital in order to generate more innovation, wealth and employment, a generally higher standard of living, and above all the preservation of individual rights, individual preferences, and individual choices. It is in my view this moral high ground that must guide all Europeans of good faith against tax centralization on this Continent.