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# The Threat of Tax Centralization Hovers Over Europe

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*Tax centralization poses a serious challenge to freedom and prosperity in Europe and goes against the continent's historical success.*

Are Europe's politicians about to undo one of the most decisive safeguards for freedom on the Old Continent? These days the talk in European chancelleries is all about clamping down on citizens who seek to protect their wealth in more amicable environments. The European Union and its predecessors have been progressively centralizing tax systems in Europe since the 1960s. But with bloated, unreformed welfare states confronted with unfavorable demographics, politicians are now more desperate than ever for revenue. The consequences are increasingly disquieting.

One of the most visible measures against European citizens is the German secret service's purchase earlier this year—for 4.2 million euros—of client data stolen by an employee of a private Liechtenstein bank. Peer Steinbrück, Germany's finance minister, described it as "an investment with a sensational return, the deal of my life." It is expected that the German government will confiscate at least 300 million euros of undeclared wealth. In a gesture akin to sharing the loot among comrades-in-arms, the German government passed on banking data concerning citizens of other countries to its respective counterparts. The support of both the EU and the Organization for Economic Cooperation and Development (OECD) for the German government's action left no doubt that from now on the end would justify any means.

Meanwhile, the most productive Germans are fleeing the country, most to take up residence just south of the border, in non-EU Switzerland, causing even more frustration in Berlin. In the last four years no fewer than 68,000 Germans chose to emigrate to the Alpine republic, where the tax burden is on average a third lower. In 2007 alone, 29,309 German citizens made Switzerland their home—a historical record. But the Germans, as the French and Italians have notoriously done for a long time, are also evading the state within its own borders. With the largest tax increase since the end of World War II implemented by the Merkel government in 2007, the German underground economy is estimated to have grown to 14.7 percent of gross domestic product last year. Faced with such trends, no wonder Europe's politicians are becoming increasingly nervous.

In their fight for self-preservation, the EU is a welcome tool. It can be used to make less competitive those countries deemed too attractive and thereby stem the citizens' option of last resort: "voting with their feet" and leaving their country altogether. The EU is even reintroducing control of cash movements. Travelers entering or leaving the EU are now required to make a declaration to customs authorities if they are carrying "cash of an amount of 10,000 euros or more (or its equivalent in other currencies or easily convertible assets such as non-crossed checks)." Undeclared cash may be "detained." Almost 20 years after the fall of the Berlin Wall, the European Union is busy building new barricades.

## "Coordinating" Tax Policy

Tax centralization at the EU level progresses at a much faster pace than is generally perceived. Although the EU denies being concerned about tax rates, the European Commission, backed by high-tax governments, openly pursues the protection of its member states' tax revenues against "harmful tax competition" and promotes the "coordination" of tax policy. The Commission thinks that upholding the unanimity rule for all tax decisions—a rule that still applies—will make it difficult to achieve the tax coordination it strives for. It has therefore proposed a switch to qualified-majority voting in many tax areas. To facilitate short-term advances, the Commission has also begun to favor "soft" but politically influential measures by drawing up "codes of conduct" and recommendations rather than legislative proposals. Closer forms of cooperation among groups of states sharing the same position are also pursued.

The EU seeks to track European taxpayers by aiming for as extensive an exchange of information among tax authorities as possible. The most striking example of this is the Savings Tax Directive, in effect since mid-2005, under which each member state must set up an "automatic exchange of information" to notify other member states when their citizens earn interest income outside their home countries. Only Belgium, Luxembourg, and Austria are being permitted a transitional period during which they levy a withholding tax instead of violating bank secrecy. The EU so far has also signed equivalent withholding agreements with five nonmember European states, including Switzerland, that have refused to set up an automatic exchange of information. Although the EU directive has been downplayed as being full of loopholes, in 2007 the withholding tax resulted in an additional burden of 653 million Swiss francs for EU residents saving their assets in Switzerland, and the EU now seeks to extend the agreement to other financial transactions.

Faced with the global mobility of capital, the European Commission is also attempting to include Hong Kong and Singapore in its international chase of EU savers, though unsuccessfully so far. The Asian jurisdictions are more reluctant to turn themselves into agents for the European tax authorities. In the United States, where according to an official survey European residents have deposited more than $1.7 trillion, the government refused to reply to the European Commission's invitation to abide by the directive. The Commission is also contemplating the inclusion of Bahrain, the Bahamas, Canada, Dubai, Macao, and even Japan in its plans. This is clearly the next logical step in the EU's ambitions: a global tax cartel designed to follow European "tax evaders" fleeing from what must be seen, by the same analogy, as the EU's "tax prison."

On the corporate front, European governments are even bolder. The German and French finance ministries intend to push the long-standing proposal of a "common consolidated corporate tax base"—a standardized measure for corporate income taxes. It is obvious that such a project is an important step toward tax centralization. The German finance minister makes no secret of it and has already called for a minimal tax rate of 30 percent on corporate income. He can count on support from the European commissioner for taxation, Lázsló Kovács, a former Hungarian communist apparatchik, who insists that "tax obstacles" would be lifted by a uniform approach. In much the same way as the planned economy was supposed to eliminate the costly duplication of market competition, the common tax base is supposed to eliminate the compliance costs of 27 tax authorities. Although competition between states, which enjoy territorial monopolies, cannot really be compared to market competition, experience shows where tax centralization leads.

In the case of the value-added tax (VAT), the EU similarly started by homogenizing the different tax bases. Later, at the insistence of the German government, it ended up standardizing the minimum VAT rate at 15 percent. At that time all countries went along because few governments could resist the comfort of a Europe-wide tax floor for a tax that collects more than a third of all revenues across the EU. Besides the VAT, the EU has also standardized excise taxes on alcoholic beverages, manufactured tobaccos, and energy products. With the customs union, the EU has also standardized tariffs and agricultural duties, which go directly into its budget. Estonia, for example, which had a more open trade policy, had to adopt the 10,794 tariffs in effect in the EU when it joined the organization. Tariff centralization prevents any country from moving to a more open trade policy and initiating a virtuous circle of trade liberalizations through emulation.

## “Fiscal State Aid”

The Commission also uses the dubious concept of “fiscal state aid” to force more “competitive” governments to discontinue attractive tax regimes. This conceptual drift is hazardous in more than one respect. First, by considering less onerous taxation as equivalent to a subsidy, the Commission makes no distinction between “not taking” and “giving.” Second, by characterizing less-heavy taxation as “aid,” the Commission explicitly implies that all resources belong to the state, which is then entitled to allocate them between the private and state sectors. This political appropriation of resources is striking when the Commission defines state aid—including “fiscal state aid”—as “state resources in any form whatsoever which distorts or threatens to distort competition.”

No other tax dispute demonstrates the EU's bad faith as clearly as its current disagreement with Switzerland. Last year the Commission declared that some longstanding Swiss tax rules applicable to administrative, holding, and service companies constitute a form of state aid incompatible with the proper functioning of the 1972 free-trade agreement between Switzerland and the other European nations. The Commission was only taking up complaints introduced by some member governments, members of the European Parliament, and corporations. There can be no doubt that the intervention against Switzerland serves to protect the least competitive member states' tax revenues and, in the case of corporations, to raise the production costs for competitors headquartered in Switzerland.

The Swiss government has until now steadfastly refused to enter into negotiations with the EU. But both the German and French governments, emboldened by the recent Liechtenstein case, have promised to intensify their fight against “tax havens.” The political pressure on fiscally more attractive locations, as well as the pursuit of European savers who attempt to protect their assets outside their own countries, is steadily undermining Europe's greatest strength: its diversity. Jurisdictional diversity and the dispersion of power were decisive factors for the Renaissance, the Enlightenment, the Industrial Revolution—and the great prosperity that followed.

By limiting the ability of people to vote with their feet and take their capital with them, tax centralization favors higher tax burdens and undermines property rights. It also encourages unsustainable welfare policies and pervasive market regulation, while hampering institutional innovation through observation and emulation of best practices. The European tax cartel-in-the-making threatens to undo the conditions responsible for Europe's exceptional success and lift some of the last constraints on its high-spending, hopelessly paternalistic governments.

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