

Tax Competition

Sofia
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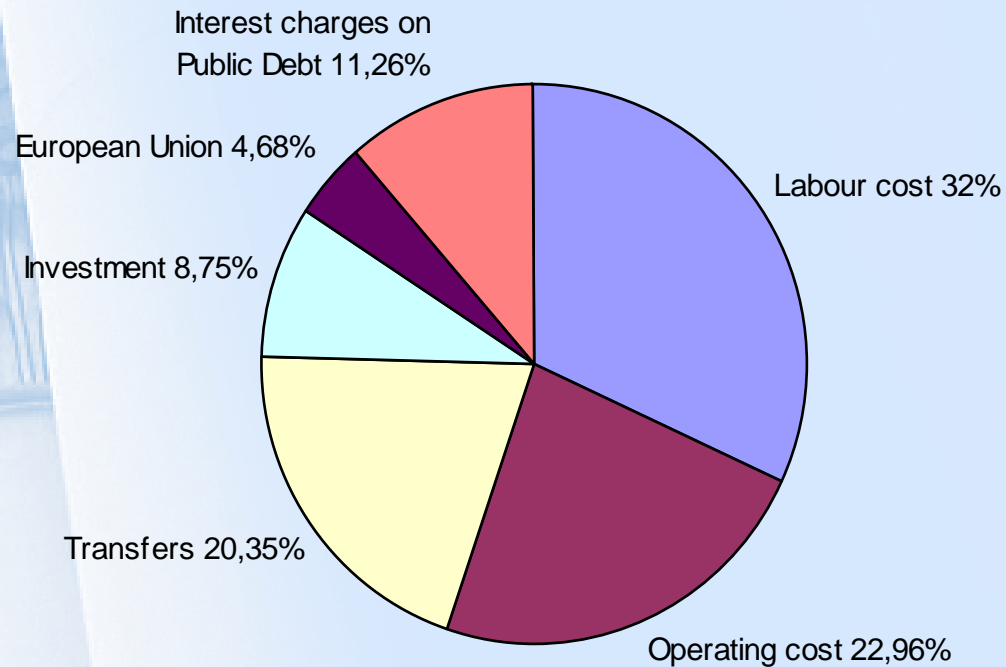
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Tax as tools for:

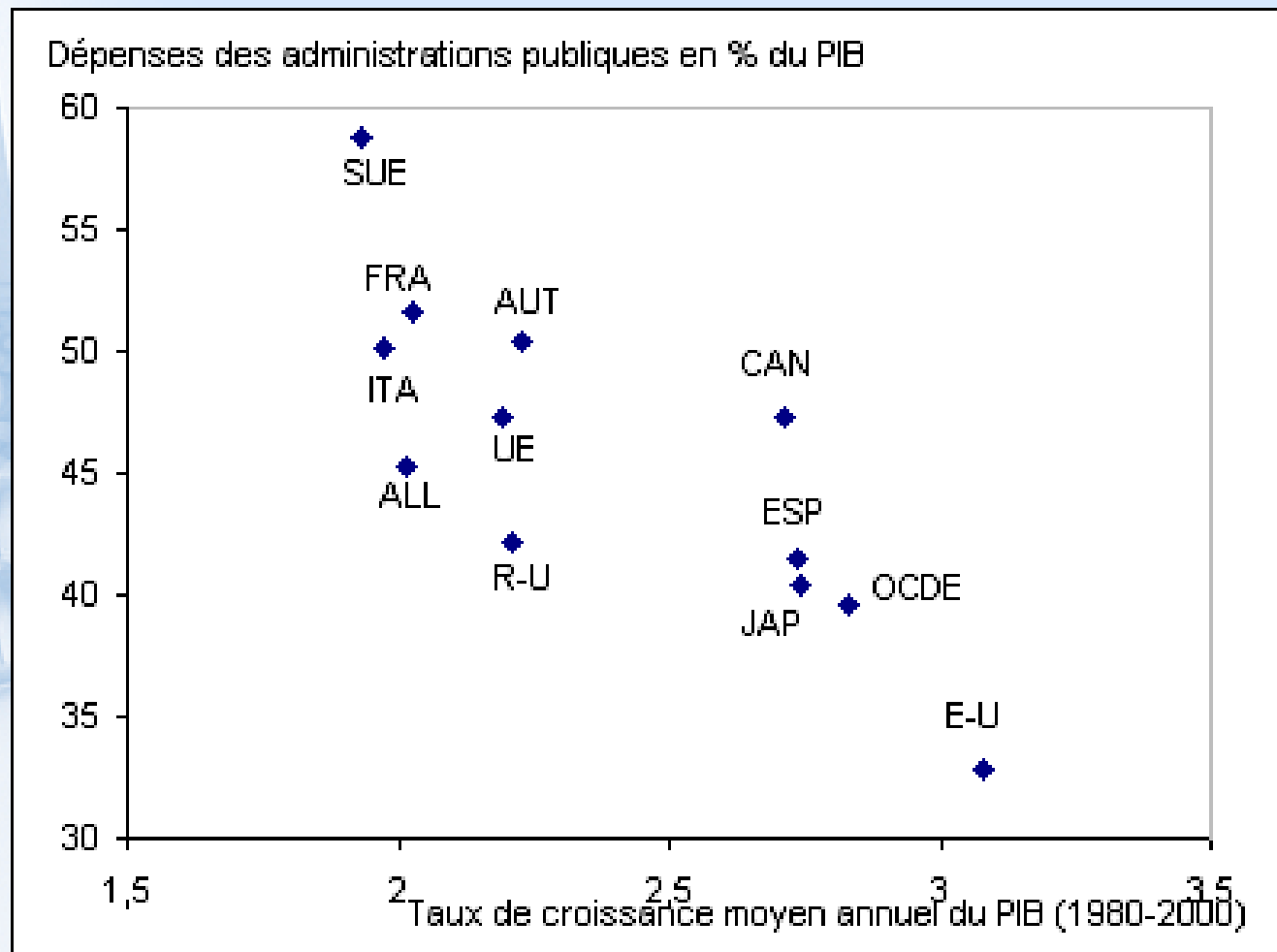
- Financing public goods
- Promote growth (investment and macroeconomic regulation)
- Redistributing wealth (from wealthy individuals and regions to poor ones)
- Happiness?

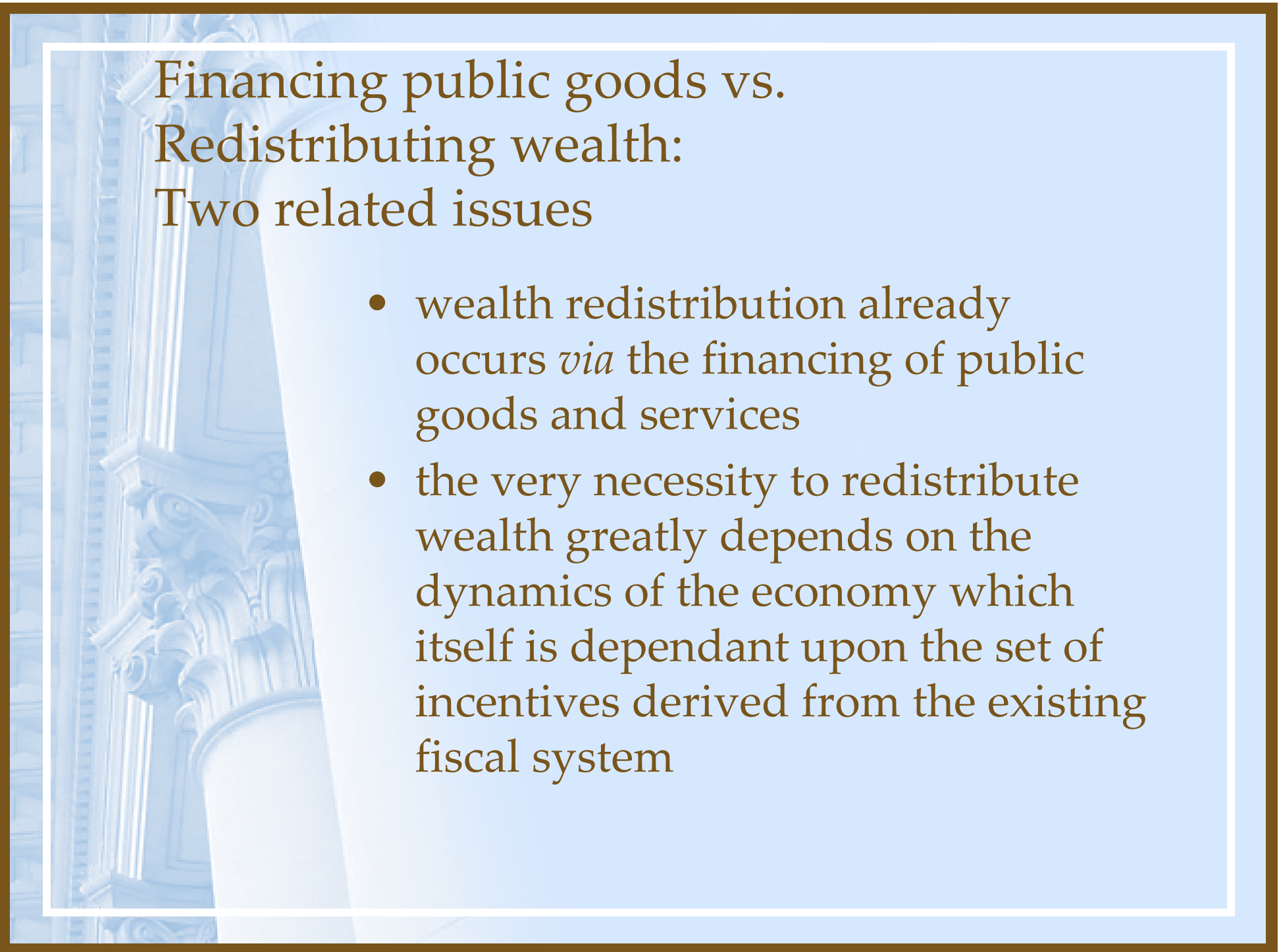
The truth is that the State redistributes a lot and invests little:

Figure 5: The Nature of Public Spending (France, Budget 2005)
Source: Own calculation based on loi des finances 2005 and INSEE



Higher public expenditures tend to be associated with *lower* growth



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Financing public goods vs. Redistributing wealth: Two related issues

- wealth redistribution already occurs *via* the financing of public goods and services
- the very necessity to redistribute wealth greatly depends on the dynamics of the economy which itself is dependant upon the set of incentives derived from the existing fiscal system

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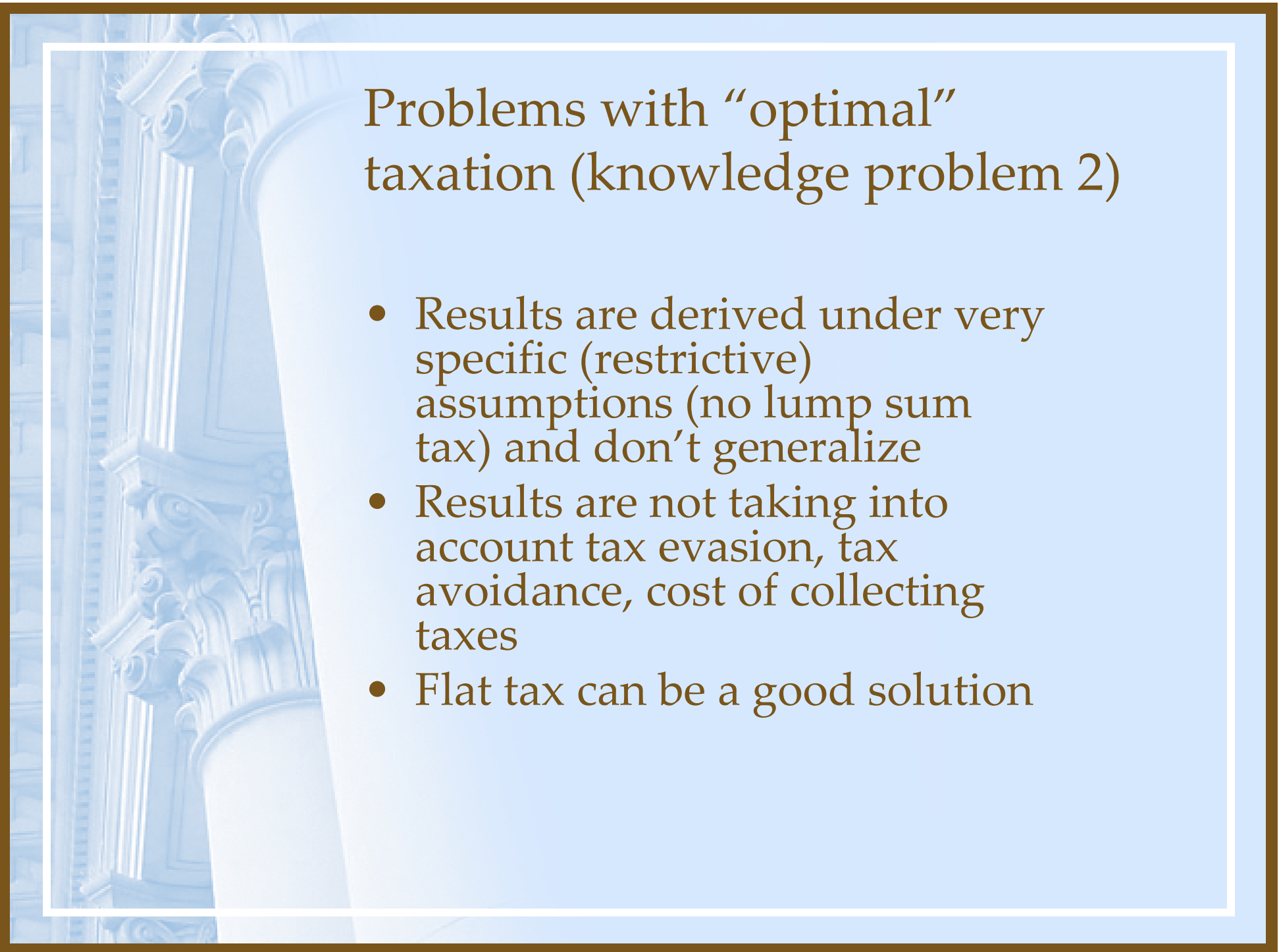
Financing public goods, and the nature of tax

- (on a voluntary basis: reputation, retaliation, *Coase...*)
- through taxes (coercion)
- Problem of avoidance and evasion (high administrative cost)
- Problem of preference revelation (asymmetric information): how do we know?
- Competition can help

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Two basic rules regarding public goods and public “services” (Knowledge Problem 1)

- Introduce competition among providers (codification of public market auctions)
- For “essential but not public” goods (education, health care): introduce a voucher system to allow access to everyone
- Tax competition can help you move in those directions


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Problems with “optimal” taxation (knowledge problem 2)

- Results are derived under very specific (restrictive) assumptions (no lump sum tax) and don't generalize
- Results are not taking into account tax evasion, tax avoidance, cost of collecting taxes
- Flat tax can be a good solution



Understanding Tax competition

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Competition in the private sphere (the market) means...

- ☑ Consumers are free to choose among goods and services offered those which fit better their needs and revenues
- ☑ The possibility for any entrepreneurially minded individual to propose to consumers a good or a service and to keep the profits made if any
- ☑ The obligation for everyone to be accountable for her/his choices.

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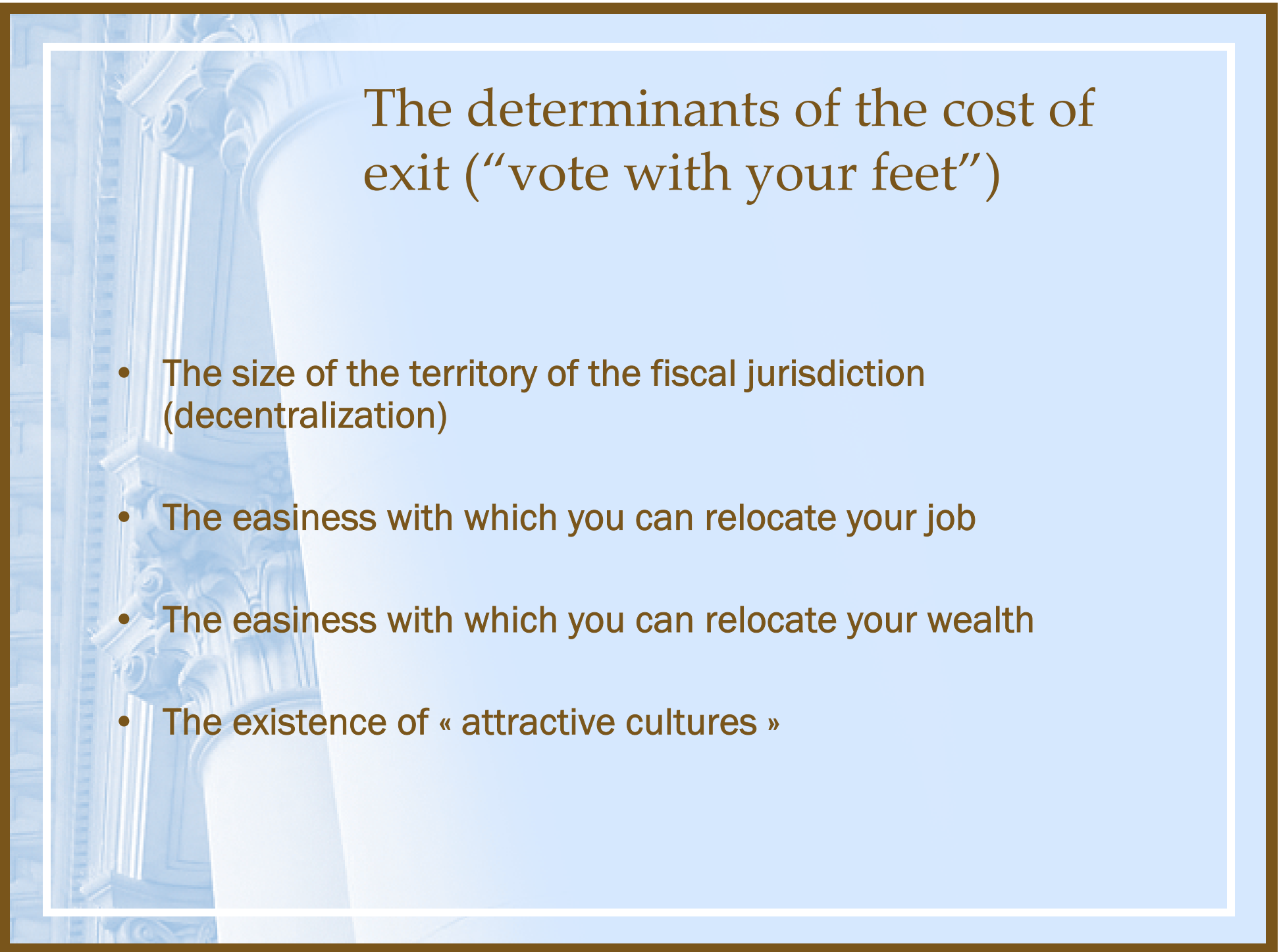
Competition brings:

- A richer diversity of products and a better adjustment of production to what individuals desire
- Better price/quality ratios thanks to a high degree of innovation
- High protection for consumers
- Kind relationships between individuals

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Is it proper to speak of tax competition?

- Territorial monopolies (a case of bundling,...)
- (The case of FOCJ: *Federal Overlapping Competing Jurisdictions*)
- *Voice or exit*
- *Exit is essential to democracy*

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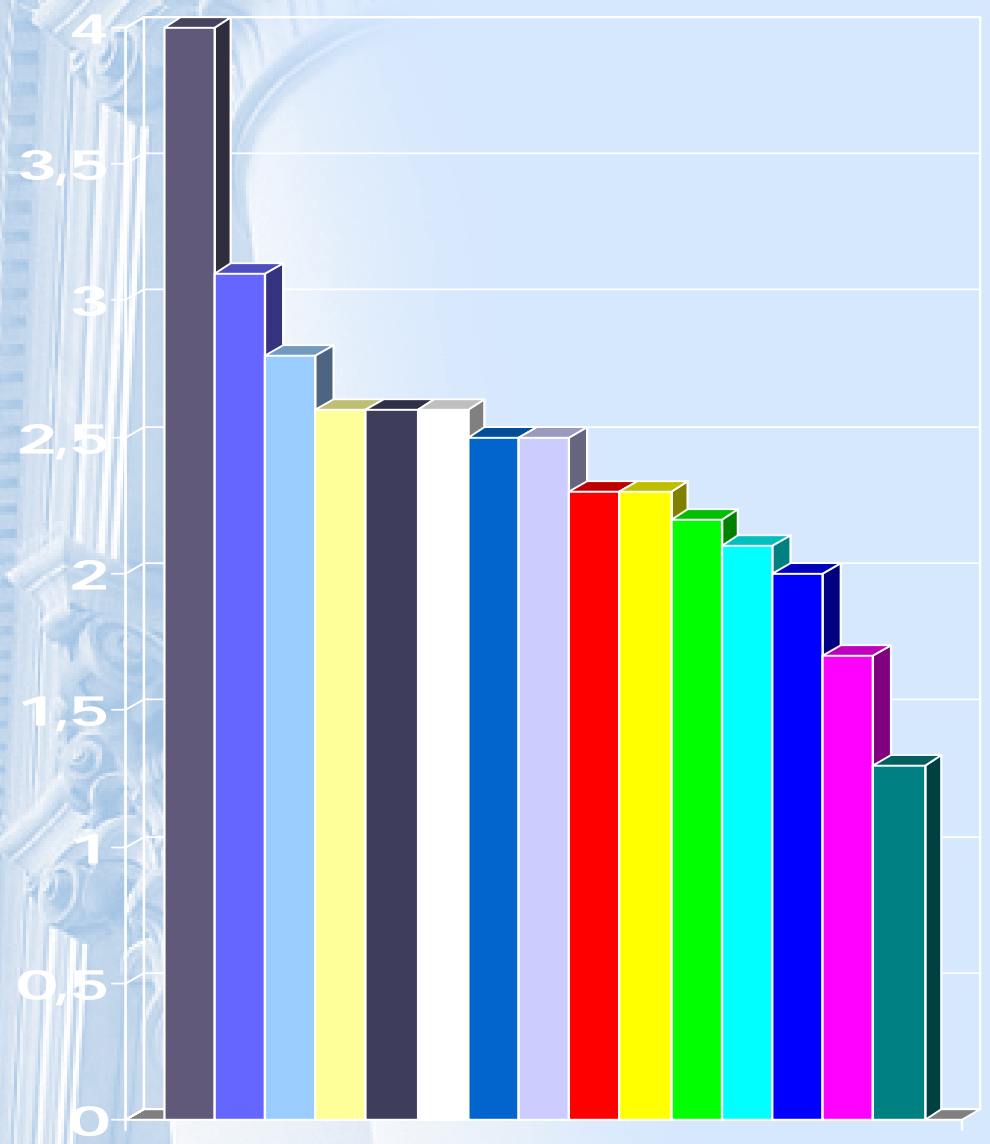
The determinants of the cost of exit (“vote with your feet”)

- The size of the territory of the fiscal jurisdiction (decentralization)
- The easiness with which you can relocate your job
- The easiness with which you can relocate your wealth
- The existence of « attractive cultures »



Voice and *Exit* reinforcing each other

- If you lower the cost of exit, voice becomes more efficient: you listen more carefully to someone who had a credible threat to leave the jurisdiction (greater accountability of public decision making)
- With more competition inside Europe democracy is stronger and individual have their dignity back



- Switzerland
- Denmark
- Sweden
- Germany
- Poland
- Italy
- Norway
- Czech Rep
- Spain
- Slovakia
- Slovenia
- Hungary
- UK
- France
- Ireland

Average

Tax power
vs.
Spending
power

Central

Local

Central


Fiscally coherent
Centralized unitary
states (Uk Ireland)

Empty Box!

Local

Fiscally incoherent
Unitary or federal
state
(Nordic countries,
Germany, France)

Fiscally
coherent
decentralization
(Switzerland)



The present and future
of
tax competition



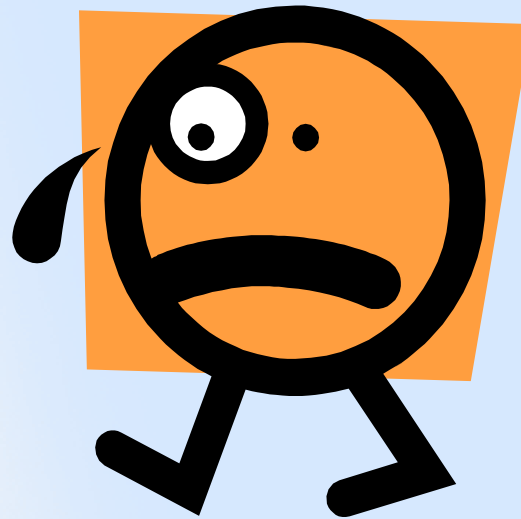
Fiscal competition is now richer because of...

- ❑ globalization
- ❑ Many countries switched to democracy
- ❑ Technological innovations
- ❑ Single market
- ❑ Trend towards decentralization in sovereign states (fiscal federalism)
- ❑ Action of civil society (think tanks, associations, medias,...)

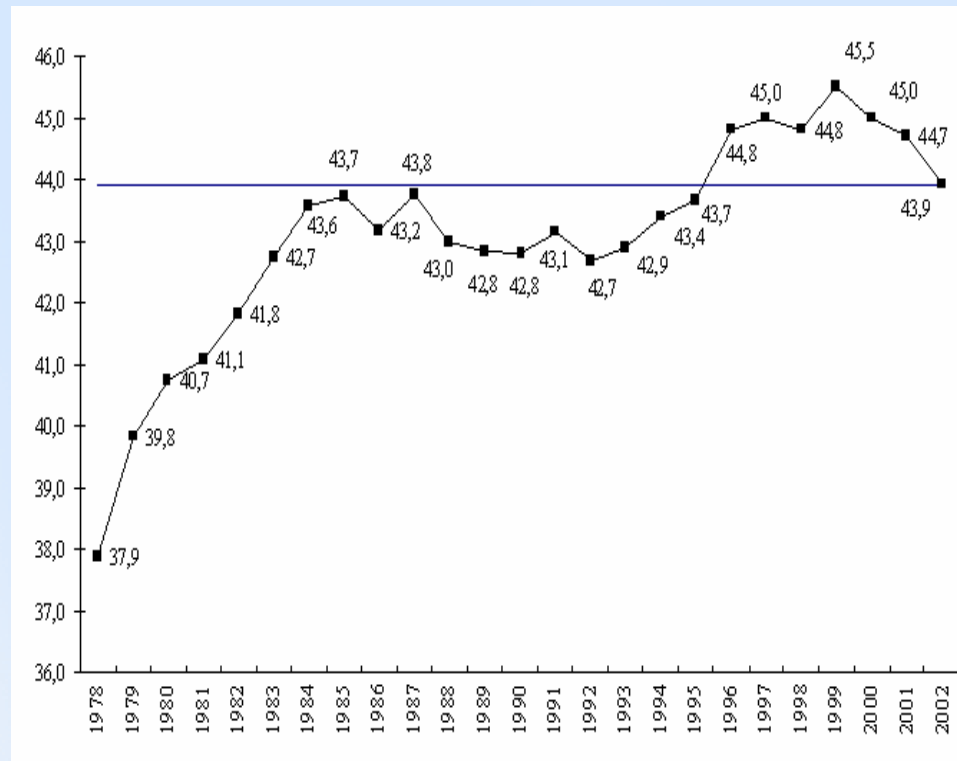
Flat tax contamination!



**But things are no longer under
control in some countries...**



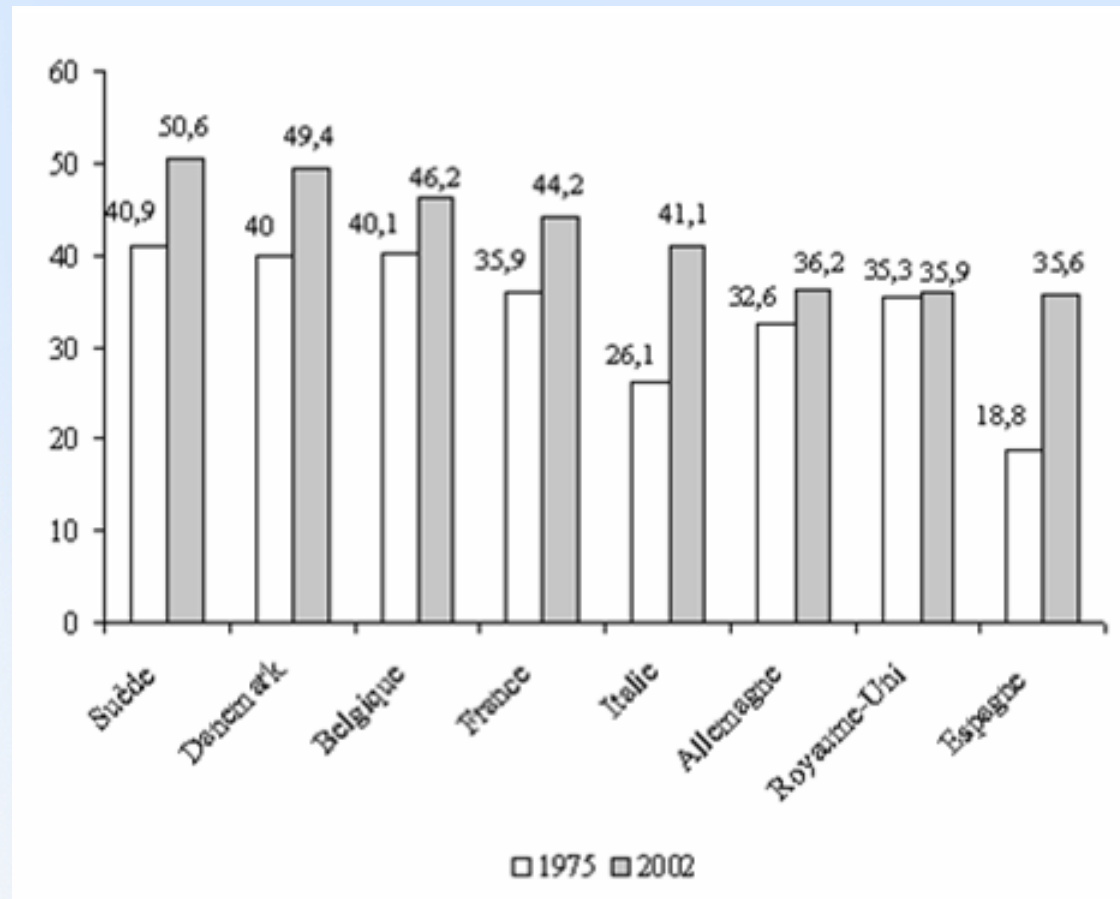
Evolution of public revenues in France since 1978 (Commission des finances du Sénat)



France's Public Debt

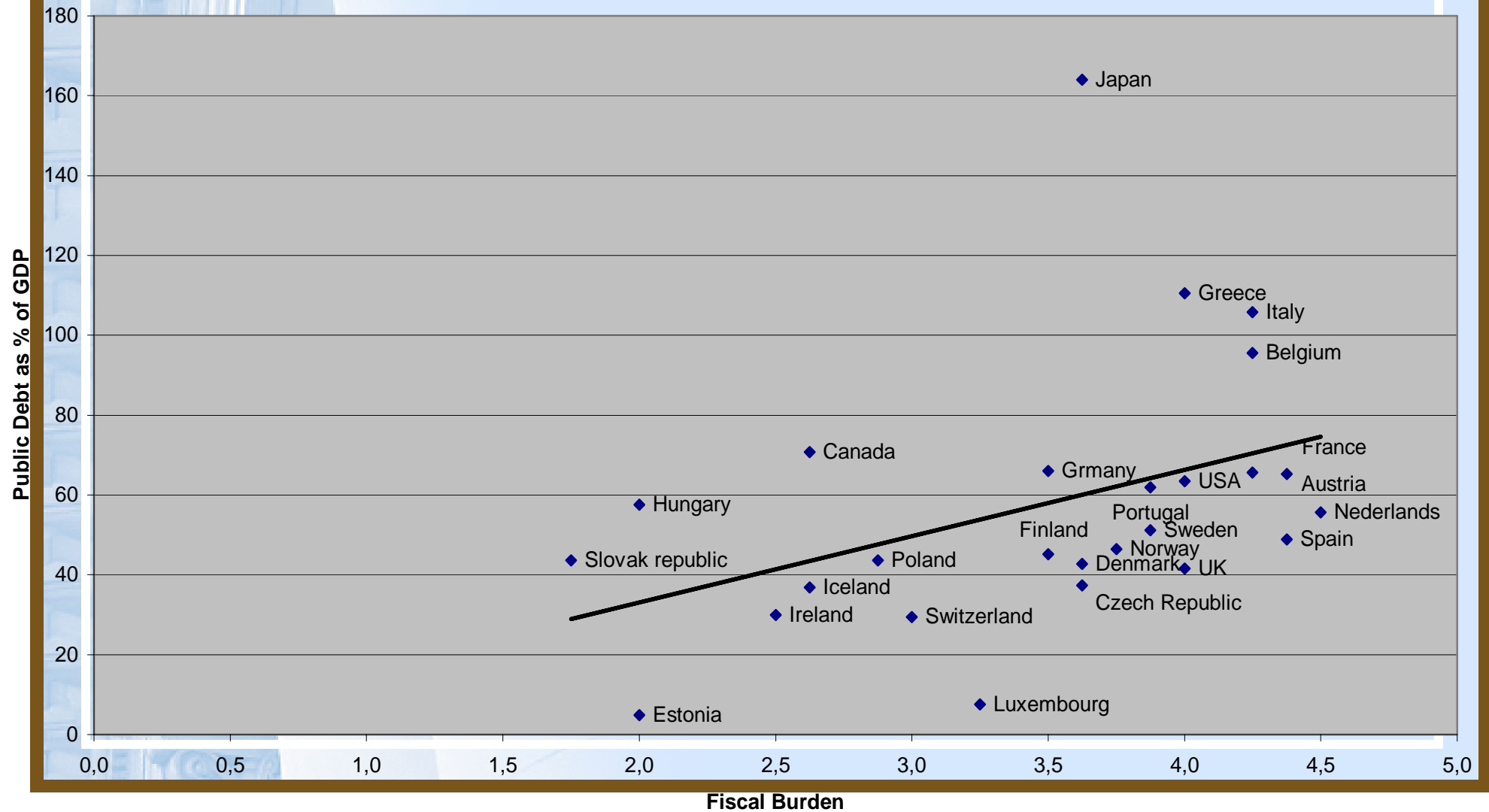
	1978	2003
Billions euro	44.4	799
% of GDP	21.3	63.7

Public revenues as percentage of GDP in EU countries: 1975 and 2002 compared



Higher taxes does not mean lower debt!


Figure 11: Public Debt and Fiscal Burden



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The tax cartel and tax harmonization

- Competition reveals that some fiscal jurisdictions deliver a service of poor quality
- Those jurisdictions (countries) will try to stop competition using EU regulation

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Fears attached to decentralization and competition:

- No economies of scale
- Spillover effects
- Race to the bottom
- Lack of competence (It takes time to learn the rules of the game and adjust behaviors)

Race to the bottom?

- ▶ Wrong in theory: a race to the bottom is logically impossible in
- ▶ Evidence of the contrary (US, think about other markets)
- ▶ Higher taxes does not necessarily mean better services
- ▶ Unbearable for less advanced countries
- ▶ Disguised protectionism, refuse to adjust and give up on privileges



Which way to happiness?



Refuse competition and increase taxes

- (The two go together)
- You don't guaranty "social peace"; you maintain privileges
- You reduce accountability
- You reduce democracy

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Accept tax competition

- An answer to the knowledge problem
- Increases freedom
- Increases peace
- Requires adjustments
- Open the door to happiness