Funding the Future

Tax competition only exists to undermine the state and ...

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Jolyon Maugham has published the most extraordinary blog this morning. Admittedly he did not write it, but given that in the nature of blogging I suspect people do not publish articles that they do not agree with his publication of this article whilst still claiming to support Labour principles is hard to reconcile.

The article, written by Irish academic Stuart MacLennan, who is an Assistant Professor at Trinity College Dublin, supposedly attacks the diverted profits tax, about which both Jolyon and I have reservations, but it does so on the basis of a fundamentalist defence of tax competition. McLennan claims that:

Tax competition is entirely compatible with, if not encouraged by, the free-trading economic model to which the UK has subscribed for the entirety of its modern history.

When did modern history begin is the question I immediately wanted to ask?

And when did we promote this free market capitalism? As far as I can see we promoted a biggish state from 1945 to 1980, then had one as matter of fact whatever was said until about 2010, and only now are actually seeing policy based on the idea of shrinking it on the assumption that the market actually knows best. Even then this is notionally being done in a deeply regulated way (even if the resources to enforce that regulation will not be available). So I would agree that we may have supported free-market economic models since a little before a week last Tuesday, but the claim that we have done so throughout our entire modern history is, to be polite, bunkum, unless modern history began in 2010.

Despite this McLennan continues:

The free market capitalism to which the Chancellor is undoubtedly an adherent sees the market allocating its resources to the locations and functions that are most profitable.

Free-market capitalism might see free markets doing that, but let's be clear about what the necessary assumptions are for free-market capitalism achieving this goal. They are that:

* There are many firms in any market.
* Freedom of entry and exit.
* All firms produce an identical or homogeneous product.
* All firms are price takers, therefore the firm’s demand curve is perfectly elastic.
* There is perfect information and knowledge.

If these conditions exist then it is possible, on an economist's blackboard, for a capitalist to make a rational choice between firms as to the best user of capital who might, on the basis of their efficiency, pay the maximum return on the sum invested and so, supposedly, produce the optimal outcome for society as a whole. But, there are one or two problems with this idea when it comes to tax competition. Take these as a sample list (there are more):

* There can only be one government in any one place: we cannot afford two as the evidence is that this results in failed states;
* Duplicate governments do not exist: in a place there is no choice of government available to a person as their can only be one competent authority and therefore market entry is discouraged (it's called war);
* By their nature governments are neither identical or homogenous: they are adapted to the circumstances of the place that they govern no one would wish it any other way;
* By definition governments are not price takers: by definition they are market-makers;
* Most governments, and most especially that of the UK, which has promoted a whole series of tax havens, are active participants in the creation of market opacity which is deliberately designed to ensure that those requiring information on the trading undertaken by major market participants is not available to them so that they can only as a consequence make suboptimal decisions.

In other words, if our Chancellor is an adherent of this idea of free-market capitalism than the difference between his assumptions and the reality of the world in which he actually operates is profound and if he has not appreciated that such differences exist then we all need to worry. Despite this McClellan suggests:

Taxation is every bit a factor in this allocation, in the same way as regulatory environment, national infrastructure, labour costs, access to materials, and market-provision. How states compete is a political choice, with differing approaches easily being attributable to the left and right of the political spectrum. While Germany may well have higher corporate tax rates, an enterprise that locates there clearly values the infrastructure and skilled workforce which that higher tax environment provides.

Tax is not a factor in this allocation: tax is a social construct designed to reclaim from an economy the money injected into it by government when it undertakes spending in pursuit of its democratic mandate, with that tax system being designed to achieve the following six goals that are elaborated in more detail in The Joy of Tax:

* Ratify the value of money by demanding that tax be paid with it;

* Reclaim the money spent into the economy by the government to prevent inflation arising;

* Redistribute income and wealth;

* Reprice market failure;

* Raise representation in a democracy by encouraging people to vote;

* Reorganise the economy through fiscal policy.

None of these is about competition: in fact, all of these are about, to varying degrees, compensating for the failure of competition. Despite which McLennan claims

However, George Osborne clearly sees Britain's competitive edge as coming, increasingly, from its fiscal policy.

The patent box has no purpose other than to encourage enterprises to locate their research and development arms in the UK. The ongoing cuts to Corporation Tax can only be construed as intended to have a similar, but much broader, effect. And it is arguable that the Chancellor is right to do so. Tax competition is intrinsically linked to the conservative free market ideology to which the Chancellor is sworn.

This is bizarre, and in direct contradiction to the claim that free markets allocate resources efficiently: anybody who believe that markets do achieve that would think that a government's attempts to interfere in that process by distorting the level playing field on which such decisions should be made are antithetical to the optimal outcome of market allocations of resources. McLennan has not apparently seen the contradiction, which then means that his further claim that the whole of the EU is found on the same, flawed, logic is simple further evidence that he does not either:

a) understand what he's claiming, or more likely

b) does understand and despite that is quite willing to suggest that the appropriate functions of the state should be distorted in the interests not of the free market, but of the rentier market that we have which exploits market capture; inequality in information availability; unequal allocation of capital which ensures somehow better access to the process of government than others; and the existence of satellite jurisdictions that are willing to sell their legislature to the highest bidder to ensure that the taxation policies of democratically elected governments are undermined all for the purposes of promoting increased inequality in society.

There really are no other options available: to promote tax competition you either have to be a naive fool or you have to be a proponent of a false ideology that does not support free markets but which does, instead, seek to undermine the state and its right to govern on behalf of the people who elected it with the aim if promoting an increase in economic inequality.

So, to get back to Jolyon's theme: if the promotion of tax competition is the only way to undermine the Diverted Profits Tax then give me the tax. Actually, of course, that is not true; the Diverted Profit Tax is flawed at a host of other levels and this recourse to a wholly false argument was, therefore, unnecessary, and all the more disappointing for that reason.