Funding the Future

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I mentioned this morning that I was debating the faults of tax competition with Arthur Laffer in the appropriate environment of the OECD today.

That debate has now taken place and I am pleased to say that I won the vote, 58% agreeing with me that tax competition was harmful, 31% agreeing with Arthur that it was beneficial and the rest being undecided.

This is, pretty much, what I said:

1 Be it resolved that: Tax competition is harmful

* Good morning.

* I am here to put to you the idea that tax competition is harmful. I do so with conviction. I am utterly convinced that it is.

* But when saying that please do not think I am saying that all competition is harmful: it is not. As a chartered accountant, a serial entrepreneur, a user of venture capital, and someone who has unashamedly made profit, I have no difficulty with the concept of competition. In the right place, at the right time, and subject to the right regulation so that all can partake on a level playing field that works for the benefit of all in society competition motivates genuine business activity and can enhance our mutual well being.

* I'll return to those conditions. But I really want to stress another one. That is that this all competition is predicated on the idea that failure is acceptable.

* And we know that failure is acceptable in business. That said, because of the scale of modern business, we have also accepted that it is so risky that we developed the concept of limited liability to socialise its consequences. The state puts us all at risk from competition amongst those in the business community because we think that a price worth paying. And that's the case because we assume that there will always be plenty of other entities to take the failed one's place when a corporation goes bankrupt.

* That assumption is usually fair if there are effective markets. It means we can afford competition.

* But there is no such protection in the case of states. The state that fails does so completely.

* And there is no alternative or parallel state that replaces the failed state: there is just economic, social and humanitarian disaster.

* And the risk of tax competition is that states will fail. Indeed, in its rawest form, that is almost exactly what tax competition is designed to induce by denying to the state the tax that is the lifeblood of its existence.

* Tax competition does not then come in harmful and benign forms as might have been implied by the OECD’s 1998 report on this issue: it comes in just one harmful variety.

* But it’s worse than that. Tax competition also undermines free, fair and competitive markets. Such markets requires that all companies compete on a level playing field and have equal access to capital. Tax competition is explicitly designed to undermine these conditions by providing some companies with an unfair and wholly artificial competitive advantage by reducing their tax rate by arbitraging tax legislation and regulation. Doing so lets them pay a higher return to capital, so distorting their access to funds, which creates an outcome where abuse of legislation can result in the determination of winners and losers in the marketplace rather than such matters being decided on the basis of who can serve the best interests of customers. Tax competition is, then, the enemy of effective market economics.

* In that case tax competition is necessarily harmful. It:
* Undermines the state;

* Undermines democracy by denying electorates the right to determine what taxes shall be paid and by whom;

* Undermines the rule of law by encouraging some to exempt themselves from that laws reach;

* And undermines free markets;

* Put those factors together and tax competition is always, and necessarily, harmful. Nothing can redeem it.

2 Be it resolved that: The cost of controlling tax competition is justified by the benefits it delivers

* There is, of course, a cost to controlling tax competition. It is, however, modest. What is more it is a price we have paid since almost time immemorial. If in doubt just read about the workings of the Temple in ancient Jerusalem. It was the regulator of markets as well as a centre for devotion. We have always known that both markets and tax can be abused. And we have thought it a price worth paying to prevent both.

* The costs of controlling tax competition relate to:
* The cost of securing international agreement to do so.

* The cost of monitoring the agreement to do so.

* The cost of exchanging information to evidence the process of doing so.

* The cost of enforcing regulation, both domestically and internationally, against those who persist in anti-democratic, anti-social, anti-market and anti-state behaviour.

* Whilst these costs are not insignificant I suggest that whatever they might be they are much lower than the gains to be made from regulating tax competition.
* The gains from regulating tax competition are based on the fact that doing so:
* Means that markets that can more effectively allocate capital to those best able to use it to meet end users need. Effective markets are, therefore, reinforced and most believe that this is a proper basis for organising large parts of most economies;

* The rule of law is upheld, with the example set reinforcing behaviour throughout society both nationally and internationally, which is why this issue has come to have such significance when much of the abuse from tax competition that has been witnessed has been by those in the public eye;

* The ability of states to deliver services to those who need them is maintained — and for the avoidance of doubt, we all need the services of states;

* Market failure — including in the mispricing of externalities — is prevented;

* Income and wealth can be redistributed, which we know leads to better societies;

* Fiscal policy becomes an option for governments, which is vital when zero rates are going to stay at or near the zero bound;

* The value of local currencies — which are always supported by the requirement that taxes be paid in them - are upheld;

* Democracy is supported.

* To put it another way, defeating tax competition is a necessary condition for effective economic management.
* To misquote Oliver Wendell Holmes:
* The cost of defeating tax competition is the price that we pay the living in a civilised and prosperous society.

3 Be it resolved that: It is possible to develop a framework to control tax competition

* The question has to be asked: can we defeat tax competition?

* My answer is yes, but we have not succeeded as yet.

* There is good reason for the fact that we have not done so: we have not as yet really comprehended the scale of the problem that we face or thought about it holistically.

* Tax competition is both created and suffered by many jurisdictions, because it comes in many forms:
* It is international;

* And as importantly, it is domestic;

* But perhaps just as significantly, it is not just about corporation tax or taxes on mobile capital. We have made the particular mistake of thinking it is mainly about corporate tax competition;

* The reality is, however, that all taxes can undermine each other and that tax systems do not suffer bilateral risk, but instead suffer multilateral failures as a result of tax competition, both domestically and internationally.

* What is more, it is not just the taxes themselves that are a threat to each other. The way in which they are operated also creates risk. So, we need to take into account:
* Political attitudes towards tax in jurisdictions.

* And the way in which tax administrations are resourced and cooperate;

* As well as the risks created by company and trust administrations

* And the effectiveness of the international agreements, so many of which are rooted in the OECD.

* In other words, to really beat tax competition we need effective multilateral, domestic and international qualitative as well as quantitative measures of tax spillovers. As yet such a system does not exist, although with my colleague Andrew Baker I am working on this issue.

* And we are doing is for good reason. It was in February this year that the United Nations, the World Bank, the IMF and the OECD all jointly committed to tackle tax spillovers. That can only be because they all perceive the threat of tax competition. We believe that a framework of the type we are creating can address this issue when as yet there is no system in place for doing so.
* It is my belief that if we increased the ambition of governments who do believe in democracy, the rule of law, effective markets and the rights of the states that they

govern then we could create and deliver these tax spillover assessments that would truly reveal where the threats to international taxation stability really are.

* And it is my belief that this would transform the stability of the world markets; focus international business on their true goal of meeting customer need to generate long-term sustainable profit for the benefit of all in society, including their owners; and it would generate the secure basis of financing that so many countries, particularly in the developing world are in desperate need of.

* That is why the cost of beating tax competition is worth paying.