The case for tax harmonisation – a French view

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The current economic meltdown should give new momentum to the fading dream of a social Europe. Growing demand for state protection and the need to co-ordinate national responses to the crisis should bring grist to the mill of the proponents of a genuine social Europe, if the EU and EMU are to survive the current crisis. This should be sweet music to the ears of the French left, who have long believed that the only way to achieve a truly social Europe was through a more political Europe. At the launch of the euro, prime minister Lionel Jospin had hoped that the single currency could protect and promote the European social model by making it easier to "regulate global capitalism … through common European action, in a Europe fired by social-democratic ideals".[1]

Many, however, expressed doubts about European countries' willingness or ability to impose a common political will on the markets, as social and Labour legislation, as well as taxation, remained under the control of national states, in the name of the subsidiarity principle. It remained to be seen whether in these fields "European governments could choose to co-operate rather than compete with a view to agreeing on a social model worth defending".[2] It is clear now that political and economic events put paid to that ambition. The fall from grace of most European social-democratic governments and their replacement by liberal or social-liberal administrations, in combination with EU enlargement, changed the socioeconomic aim of the European Union.

The individualistic, national social model

Led by Tony Blair, most EU governments were no longer concerned with shaping globalisation, but with adapting their national social models to its relentless force. Their business-driven agenda sought to "modernise" national social welfare systems through a mixture of competition, benchmarking, peer pressure and guidelines set by the right-of-centre Commission under the umbrella of the Lisbon Agenda. This meant that, in order to compete with the likes of China and India, workers were told that Europe could no longer afford the luxury of strong labour legislation and good welfare benefits and that governments had to cut welfare spending and taxation and ease worker protection and business regulation.

This race to the bottom, promoting tax and social dumping, explains why citizens began to lose confidence in the European integration process and why the French, as well as the Dutch, rejected the European constitution. All surveys show that the French are the most

1 Jospin, L *Modern Socialism* (Fabian Society, November 1999)
2 Haseler, S and Reland, J (eds) *Britain & Euroland* (Federal Trust, 2000), p135

anti-globalisation and anti-capitalist people in the OECD[3] and that they are deeply attached to the values of equality, solidarity, community and social cohesion. Therefore, it is not surprising that a clear majority of French socialist sympathisers felt strongly that:

... the old social democratic or Christian-democratic vision of Europe was giving way to the British-led vision, espoused by new members and backed by a technocratic and dogmatic neo-liberal commission. They rejected a Europe intent on promoting "pure and perfect competition" as the linchpin of economy and society, which distrusts anything that is public (contrary to French tradition) and praises private business.[4]

The "Bolkenstein" Services Directive, proposing that workers could work anywhere in Europe under the conditions of a firm's national tax and social legislation, had further convinced them that, far from attempting to protect its workers from the downside of financial globalisation, the EU – which took pride in having the most stringent competition policy and on being the most open economic bloc in the world – had swallowed the neo-liberal agenda hook, line and sinker.

Never one to ignore the zeitgeist, Nicolas Sarkozy often condemned in his campaign a Europe "which frightens rather than reassures". That is why, when helping to negotiate the new treaty, he had insisted on removing the words "free and undistorted competition" from the text, even if the principle remains in many of its articles, and had stressed that "the word 'protection' is no longer taboo".

Sarkozy seemed to have forgotten about the need to promote the social dimension of Europe, and had not made it part of the French presidency's four priorities, until it was hurriedly added to the mix in the week following the Irish vote. Instead, his main concern was to "modernise" the costly French social model (second-highest in EU at 33.2% of national GDP in 2006, compared with 26.4% in UK and 29.7% in Germany), mostly funded by the workforce and employers and therefore seen as an obstacle to competitiveness and higher employment, even though he knew he would face great resistance from unions and demonstrations by people still attached to their tried and tested generous model, in spite of its shortcomings and financing problems.

The global financial disintegration forced President Sarkozy to disown his previous admiration for the Anglo-American model and to limit his reforming zeal to cutting numbers in the public sector and tinkering with the French welfare system. Having

3 A January 2009 survey shows that 53% of French respondents feel that capitalism needs to be transformed in depth, compared with 31% in the rest of the EU.
4 Jean-Louis Andreani, writing in *Le Monde*, 24 June 2007

realised the futility of his hope to make the French more akin to the British or the Americans, he even admitted on 19 January that, in the current difficult circumstances, the highly redistributive French system, weighing in at €550 billion, constituted a "powerful stabiliser, which should enable France to retain its social cohesion through the crisis". France's generous welfare system also contributed to the 0.8% consumer spending rise in the final quarter of 2008.

This shows how the crisis has pushed into the background all the finer points of the debate on the economic and social model. The core of the debate is no longer about which one of the Esping-Andersen[5] models is best; whether the Scandinavian or the Liberal Anglo-Irish ones are, as claimed by André Sapir,[6] the most able to reconcile social justice, opportunity and economic efficiency. While there is still a need for benchmarking and new innovative approaches to social policy with a view to making our systems more responsive to individual and collective needs, the social Europe debate will surely move away from flexibility and technical and purely social measures to a broader political level.

This crisis is indeed political as well as economic, as argued by Benoit Hamon, spokes-person for the French Parti Socialiste:

The extreme liberalisation of the single market, the dismantlement of public services, the weakening of social models throughout Europe are not the result of the financial crisis, but of economic and political choices implemented by the right, which has had a majority in Europe for 10 years. The European level is the pertinent one to respond to such an intense and extensive crisis.[7]

Time to commit to a social Europe and focus on its challenges

There is now a golden opportunity to achieve the aim of the true advocates of social Europe: to converge towards a unified high standard of social protection, involving a significant level of redistribution and therefore taxation. The neo-liberal model, which parliament, the European Commission and most European governments so readily embraced, has run out of steam. We are now entering a new world, and we must abandon our utopian and counterproductive free-market dogmas and some of our free-trade tenets. Faced with a potential crisis of civilisation, we have to rethink our growth model and start focusing again on the common good.

5 Esping-Andersen, G *Three Worlds of Welfare Capitalism* (Polity Press, 1990)
6 Sapir, A "Globalisation and the Reform of European Social Models" in *Bruegel Policy Brief*, November 2005
7 Benoit Hamon, quoted in *Le Monde*, 30 January 2009

It is time for Europeans to abandon their skewed and ideological view of competitiveness. Pascal Lamy, referring to the good economic performances of Scandinavian countries, never tires of reminding us that a high level of social protection and successful participation in free trade are not mutually exclusive.

Social Europe makes economic sense in a globalised world. Not only must we be aware of the huge fiscal and economic costs of social fragmentation and dislocation, but also we must stop viewing our social protection as a handicap for our global competitiveness, and start considering it as a comparative advantage in this highly unstable world.

Now that Obama's America has begun to look kindly and even enviously at our system, we must stop regarding our system as archaic. It provides our workforce with the right level of education and security to allow them to trust in the future and make real individual choices, as the French Keynesian economist Jean-Paul Fitoussi, now one of Sarkozy's economic advisers, argued two years ago:

The reason why welfare state building has to be pursued and protectionism refrained from in developed countries has to do with the nature of our growth regime. Social protection is not charity, but insurance, ie, risk guaranteeing and innovation stimulating. Combined with a reactive macroeconomic policy, it protects individuals and firms by maintaining a high degree of economic activity … That may explain why small economies, which are the most open economies, are usually more socially protected.[8]

Although the social Europe ambition encompasses many important dimensions, such as social and wage minimums, labour legislation as well as employees' participation in company management, I would like the purpose of this paper to focus on the issue of taxation only, because it is the acid test of our commitment to social Europe.

A fairer system

We have been told for the past 30 years by neo-liberal economists (notably Professor Art Laffer) that too much tax kills the tax (ie, as tax rates rise there would come a point where people would not regard it as worth working so hard, and that the lack of incentives would lead to a fall in income and therefore a fall in tax revenue). And it was true. Our debt-fuelled growth generated a great deal of tax revenue, which helped to finance the survival of the victims of the system, of the losers. But with deteriorating public finances all over the EU, the tax take will certainly have to rise in the near future, as demands on the public purse come from all corners. However, all governments face the same

8 Fitoussi, J-P *Globalisation & the Twin Protections*, OFCE paper 2007-21 (OFCE, July 2007)

conundrum: how to increase tax revenue, while boosting, or at least preserving, demand for goods and services.

First it means making the case for taxation and redistribution and then for broadening and rebalancing the tax base, ie, closing what *The Guardian's* recent inquest into corporate tax avoidance/evasion called the "tax gap". This two-pronged attack addresses three of the main concerns of European citizens today:

- Fear of slipping through the safety net
  Redistribution is necessary and welcome in these troubled times. Welfare benefits are one of the reasons why the current crisis, deeper and more intense and widespread than that of the 1930s, will have less damaging social and economic consequences. It redistributes wealth to those who need it most in the short term, as we need to focus our efforts on the poorest and the most fragile so as to preserve social cohesion. It also improves the purchasing power of the lower-paid, who spend most of their disposable incomes. This helps to boost domestic demand for local services and goods at the expense of conspicuous spending on expensive status imports.

- Fear of unemployment
  Taxation also addresses the job issue, as it helps to finance investment in useful, less profitable but labour-intensive sectors, such as education, health, transport and energy infrastructure, ecology, nature and culture. Not only would it be good for social cohesion, but also it would be good for growth and job creation.

- Anger at growing inequalities
  Tax fairness must also be promoted, as the best and fastest response to growing inequalities. In the name of competitiveness, the tax burden became increasingly unbalanced throughout Europe, leading to lower tax on capital, on corporations and on high earners, accompanied by a higher burden on consumers and higher workers' contributions to welfare spending.

It is well documented that growing inequalities were the price to pay for the huge wealth-creation preceding the crash. In its June 2007 report, the OECD said that globalisation had increased inequality in 18 of the 20 richest nations in the world. In the US, the 1% richest households were earning $600,000 more than in 1979, compared with just $7,000 more for the 80% least well-off.[9] A change in our taxation policy would be the fastest, most effective and most appropriate way to correct such inequalities and start putting an

9 OECD *Employment Outlook* (June 2007)

end to the recent and, hopefully, redundant "winner takes all" social model.

A fairer tax burden would help to correct inequalities quickly without complex legislation. Desperate times call for desperate measures. After all, the marginal US income tax rate rose from 25% in 1929 to 79% in 1936, then 91% in 1940. We do not have to go that far, but it is time to turn the tide and tax those who have profited most from the boom, rather than tax them less to retain them. Where would they go, if they faced the same rules throughout the EU?

The largest loss to state coffers is definitely the result of tax avoidance, especially on the part of corporations. Corporate tax avoidance has become so widespread and so huge that a 2005 report by Jason Furman, Jason Bordoff and Larry Summers estimated it at 16% of the US tax revenue in 2003. You can be sure that this figure has not decreased since. They pointed the finger at tax havens, but also at some EU countries, such as the Netherlands and Ireland, where US multinationals paid 5.3% and 6.1% tax on their profits artificially registered there. While all governments, including the repentant British one, are now calling for global action against tax havens, which will be at the top of the G20 London summit, European ones have not yet pointed the finger at intra-European tax competition.

The case for tax and social harmonisation

European countries must stop using tax and social legislation as tools of intra-European competitiveness. They must begin to harmonise significantly their fiscal and labour laws. You cannot argue that protectionism is the greatest danger facing the global economy and the EU, while at the same time using social and fiscal forms of protectionism. This point was made in a radio programme by Raymond Soubie (principal social policy adviser to Nicolas Sarkozy and to many previous French governments of the left and right) in response to accusations of protectionism over subsidies to the French car industry:

We know many European countries in the East or North East of Europe which have, for years, implemented tax systems with hardly any corporate taxation that are tantamount to tax dumping. They must not now accuse us of protectionism, when they have deliberately pursued protectionist policies.[10]

In the same way as governments have become aware that economic co-ordination is now required, if far from achieved, we have to co-ordinate our social and tax policies as well as our economic policies and we have to do it in an intelligent and positive manner if we are to avoid a damaging competition between social systems.

10 Raymond Soubie, quoted in *Le Monde*, 17 February 2009

As far as capital and corporate taxation are concerned, it would not be wise to standardise completely, as this would be detrimental to the poorer EU countries, but it would be judicious to at least standardise our tax base and harmonise our tax rates within the EU to prevent unfair competition – a point made by many, especially in France, for quite a while:

Basically, Europe can choose between two strategies. The first consists in maintaining the European social model, characterised by a significant level of transfers, public expenditure and thus of taxation. The system will have to be preserved from tax competition by harmonisation in Europe that will have to include the prohibition of unfair competition, the introduction of minima rates in certain cases, and by tough measures against tax havens at a worldwide scale … The second strategy consists, on the contrary, in moving towards a more liberal model, where privatisation of welfare will allow for cuts in tax rates that are assumed to promote employment, education and vocational training, savings and investment. This strategy supposes that Europeans agree to live in a society with rising inequalities. Tax competition would then be a tool to support this trend.[11]

This is the real challenge for all progressive parties. The time is ripe to think afresh and to propose a new growth model. Now is the opportunity to wave goodbye to our consumerist, individualistic, materialistic culture and give ourselves the means to build a better, more equal, ecologically and socially sustainable society. The time has come to re-empower political will over market forces. The European elections will provide the left with the opportunity to put that argument to the people. They are now so angry that they might be willing to hear it.

11 Sterdyniak, H *Taxation in Europe: Towards More Competition or More Co-ordination*, OFCE paper 2005-19 (OFCE, December 2005)