EU Tax Trap

It's time Washington pulls the plug on the latest Brussels tax harmonization gambit.

BY DANIEL J. MITCHELL

In today's modern economy, it is increasingly easy for jobs and capital to migrate from high-tax nations to low-tax nations. This forces lawmakers to control taxes and spending lest they drive too much economic activity to lower-tax jurisdictions. This process is known as tax competition, and it is a liberalizing force in the world economy.

But not everybody approves of tax competition, especially high-tax European governments such as France and Germany. Using the European Union as their vehicle, these uncompetitive nations are seeking to replace tax competition with tax harmonization—sort of an "OPEC for politicians." There already is a requirement that all EU-member nations have a value-added tax of at least 15 percent, and the Brussels-based bureaucracy is seeking to harmonize taxes on corporate income, tobacco, energy, and digital products. And politicians like French Prime Minister Lionel Jospin and German Chancellor Gerhard Schröder openly assert that the EU should determine tax policy in member states.

But European taxpayers should not give up hope. European nations that benefit from tax competition—such as the United Kingdom, Ireland, and Luxembourg—likely will use their EU veto to block any meaningful proposals to further harmonize tax systems. And even if the U.K., Ireland, and Luxembourg agree to surrender their fiscal sovereignty, high-tax nations will not stop the exodus of jobs and capital so long as non-EU jurisdictions offer a more attractive economic climate. In other words, a cartel will not work unless every nation participates in the cabal.

This is why the European Union's latest tax harmonization initiative—the "Savings Tax Directive"—seeks to include non-EU nations, such as Switzerland and the United States, in the cartel. Under the proposed Directive,[1] all participating nations would be expected to collect and swap confidential financial data about the investments of nonresidents. If this assault on privacy succeeds, an overburdened French taxpayer no longer would be able to escape oppressive French tax rates by shifting his savings to another jurisdiction.

It is quite likely, though, that the EU's Savings Tax Directive will fail. Any EU member nation has the right to veto the proposal, and Luxembourg, Austria, and Belgium clearly are not interested in changing their privacy laws just so other nations can tax income earned inside their borders. An even bigger obstacle is that the Directive is contingent on the approval of Switzerland, Liechtenstein, the United States, Monaco, Andorra, and San Marino. These are all capital-inflow jurisdictions that are among the world's biggest beneficiaries of tax competition. It is difficult to imagine, for instance, Switzerland voluntarily surrendering its competitive advantage in the global economy.

But little nations should not be the ones to kill the EU Directive. The United States should take that role, if for no other reason than to antagonize the French

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government. But annoying European elites is just a fringe benefit. The real reasons to oppose tax harmonization include:

Threat to tax reform. Tax reform proposals generally are based on important principles such as taxing income only once and taxing only income earned inside national borders (territorial taxation). The EU Directive, by contrast, exists so that high-tax governments can double-tax income—even if that income is earned in other nations. Any government that acquiesces to the EU Directive, for all intents and purposes, gives up on tax reform.

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Threat to tax cuts. The Reagan and Thatcher tax-rate reductions triggered lower tax rates in every other industrialized nation. The vast majority of those tax cuts occurred because governments were afraid that too much capital was fleeing to the U.K. and the United States. But if the EU succeeds, governments will not face that pressure since they will have the ability to tax flight capital.

Threat to good economic policy. Competition is the heart and soul of economics. But the EU believes in Capital Export Neutrality, a peculiar theory that argues that the economy will suffer if people allow taxes to affect their decisions on where to work, save, shop, or invest. This is why the EU supports tax harmonization, either explicitly (by fixing tax rates) or implicitly (by information exchange).

Threat to sovereignty. Governments should have the right to determine how—and if—income is taxed within their borders. According to the EU, however, a nation is not allowed to determine its own tax and privacy laws if those laws make it more difficult for high-tax governments to enforce bad tax law. Supporters of the EU agenda will not be satisfied until every nation is compelled to be part of the cartel.

Threat to U.S. economic interests. By industrial-world standards, the United States is a low-tax country. America's aggregate tax burden is less than 30 percent of GDP, much lower than the 42 percent average tax burden in EU nations. Combined with extremely attractive tax and privacy laws for foreign investors, this explains why the U.S. economy has attracted more than $9 trillion of overseas capital—nearly two-thirds of which is financial capital. Needless to say, a substantial portion of that money will leave the American economy if the EU succeeds.

Threat to individual liberty. People should have the freedom to escape fiscal oppression. This principle applies to Argentines who don't want their government to steal their savings. It applies to the overseas Chinese who don't want the Indonesian government to confiscate their wealth. And it applies to French taxpayers who are getting fleeced by their government. The EU Directive, however, would create a world where financial privacy is a fiction and human rights take a back seat to extra-territorial enforcement of bad tax law.

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The European Union began with a noble vision—a free trade area that allowed the free flow of goods, services, capital, and labor. Today's European Union is betraying this vision. Selfish politicians are trying to inhibit competition in order to prop up inefficient welfare states. The United States may not have much influence on what happens within the EU, but at least it can defend its own interests—and protect the interests of European taxpayers—by pulling the plug on the Savings Tax Directive. ◆

[1] for more information see *http://europa.eu.int/comm/taxation_customs/publications/official_doc/IP/ip011026/memo01266_en.pdf*