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This paper addresses some important issues in the policy debate over capital taxation in Europe. The title belies two problems of historical significance in Europe— the quick responsiveness of capital to tax changes (‘capital flight’) and non-cooperative behaviour in setting tax rates on real investments (‘tax competition’). Much of the discussion extends previous work by Giovannini on the need for stricter application of the ‘worldwide principle’ or (‘residence principle’) of taxation. A focus on eliminating impediments to the worldwide principle is a useful one, as it shifts the focus of policy debates away from ‘harmonization’ per se.

The Giovannini–Hines paper is not an exercise in optimal taxation, it constitutes a specific policy proposal. I shall frame my remarks accordingly, though, at points, I shall question the merits of specific aspects of the plan as against obvious alternatives.

The basic idea is as follows. Let us suppose that we want a corporate-level tax. Suppose also that we want to mitigate distortions (e.g. avoid ‘tax competition’), but, at the same time, raise revenue. Three issues arise in designing such a tax in the context of present institutions for taxing multinational corporations: (i) problems of deferral; (ii) the lack of integration of corporate and individual taxes; and (iii) defining the appropriate tax base. After reviewing briefly parts of the background discussion in the paper germane to the policy proposal, I shall discuss these issues.

1 The context: distortions in European capital taxation

Giovannini and Hines begin by noting that capital tax revenues as a percentage of gross domestic product are lower in the EC than in the US. Such comparisons are inevitably difficult, owing to measurement issues
Hines review ‘ability to pay’ and ‘benefits received’ in rate taxation. The former is unconvincing when applied to a source-based basis in all likelihood. The latter presumes a benefit to incorporation. Even this is difficult to find. For example, large-scale US under-profitability governance in recession for a corporate-level tax are more likely to be ‘extraterritorial’ (e.g. to the extent that revenue is more diffuse, and so on).

Perhaps the most significant problem with the idea that associated with measuring income (re-)incentivises internationally in this respect noted by the tax alternative which circumvents many of the prohibitions. A corporate cash-flow tax falls ultimately in monopoly power, ideas, entrepreneurial skill, and so on, and financing distortions. In addition, no need for crediting foreign taxes paid, effectively a partner in firms’ equity). Raising important consideration. Studies for both the US (by Aaron and Galper, 1985) have shown the tax could raise similar revenue as that under.

Giovannini and Hines argue that, under the temptation towards high rates (presumably seems disingenuous. Time-inconsistency problems of fiscal reforms. The point would have equal income tax. Drawbacks of switching to cash flow difficulties in designing transitional arrangements will also be required in the implementation.

2 The Giovannini–Hines plan as a reform

The GHP is a well-reasoned attempt to reform taxation in Europe. The critical question of how to mitigate the significant distortions in the present system are as follows. First, we are given no distortions under the present system actually noteworthy in a ‘practical corporate tax’ proposal that the GHP addresses the significant underlying-income required in any corporate-income-tax system.

I would like to see the authors expand their analysis and consider questions like the following.
Hines review 'ability to pay' and 'benefits received' rationales for corporate taxation. The former is unconvincing in this context. Taxing foreigners on a source-based basis in all likelihood redistributes rents. The latter presumes a benefit to incorporation. Even here, convincing arguments are difficult to find. For example, large-scale enterprises have emerged in the US under partnership governance in recent years. Realistic motivations for a corporate-level tax are more likely to centre on the need for revenue (e.g. to the extent that revenue is more difficult to collect at the individual level).

Perhaps the most significant problem with corporate income taxes is that associated with measuring income (recall the significant differences internationally in this respect noted by the authors). One corporate-level tax alternative which circumvents many of these problems is a 'cash flow' tax. A corporate cash-flow tax falls ultimately on rents associated with monopoly power, ideas, entrepreneurial skill, etc. The tax avoids both investment and financing distortions. In addition, at the margin, there is no need for crediting foreign taxes paid (since the government is effectively a partner in firms' equity). Raising revenue is, of course, an important consideration. Studies for both the UK (by Mayer, 1982) and the US (by Aaron and Galper, 1985) have estimated that the cash flow tax could raise similar revenue as that under an income tax at lower rates.

Giovannini and Hines argue that, under a cash flow tax, there is a temptation towards high rates (presumably to confiscate rents). This seems disingenuous. Time-inconsistency problems are common to a host of fiscal reforms. The point would have equal force applied to a true income tax. Drawbacks of switching to cash flow taxes have more to do with difficulties in designing transitional arrangements. Some transitional arrangements will also be required in the implementation of the GHP.

2 The Giovannini–Hines plan as a reform

The GHP is a well-reasoned attempt to reform the system of capital taxation in Europe. The critical question, of course, is to what extent it mitigates the significant distortions in the present system. My two reservations here are as follows. First, we are given no evidence on how large the distortions under the present system actually are. Such an omission is noteworthy in a 'practical corporate tax' proposal. Second, it is not clear that the GHP addresses the significant underlying problems of measuring income required in any corporate-income-tax systems.

I would like to see the authors expand their analysis of the proposal to consider questions like the following.
What are the efficiency gains from the new system? Suppose such gains are large. How would the gainers compensate the losers (presumably significant for political viability)? The GHP takes away the ability of countries to tax directly corporate income earned within their borders by firms owned by non-Europeans. Are their implications for ‘outsiders’ (in particular, US firms) with respect to corporate takeovers, etc.? There are limits on the ability to subsidize domestic investment. What happens in response to a shift in investment incentives in the US? Since Europe is not the world, there presumably must be adjustments in European rates in response to major shifts in capital tax systems in the US. How would renegotiation of the European ceiling rate occur?

These questions notwithstanding, Giovannini and Hines have done an excellent job in presenting the issues and suggestions for reform. The paper should draw attention both from academic researchers assessing the efficiency costs of alternative systems and from policy-makers balancing the need for reform with national political concerns.

NOTES
1 See Giovannini (1989).
2 Of interest here as well is Giovannini’s (1988) previous research suggesting that, historically, there may have been large behavioural responses to capital levies associated with wartime finance in Europe.
3 Alternative corporate cash flow bases are reviewed in King (1986).

REFERENCES

8 Reflections of a common monetary system

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1 Introduction: sense and importance

The much increased likelihood of monetary integration – and even a single currency in the long term future – has not surprised excepting the coordination of fiscal policies. The Delors Report (1989) makes a clear move towards a greater commonality among participants in the existing European Monetary System (EMS).

A monetary union would allow the formulation of economic policies with the understanding that the conduct of a common monetary policy would be placed within an agreed framework and the economic consequences of decisions would remain containable. However, given the external economic situation, the need for an overall policy stance flexible enough to handle differences between member countries in the financing of budgetary deficits.

1.1 No deficits, please

There are frequent further references (including national budgetary policy. The Report becomes rather specific control national public sector deficit)