Commissioner Moscovici's keynote address: The political economy of tax reforms

Introduction

Ladies and Gentlemen,

It is my pleasure to join you today and to contribute to your discussions on the political economy of tax reforms. As today's presentations and discussions have shown, tax reforms face a significant number of political obstacles, which require specific strategies to be overcome.

I would like to outline challenges governments are faced with in implementing tax reforms, to stress the importance of balancing efficiency and fairness considerations and also to underline the role the European Commission can play in helping Member States designing and implementing their reforms.

Challenges faced in implementing reforms

As part of a successful reform strategy, the potential political obstacles of planned tax measures should be assessed early on, alongside their economic and redistributive features. Therefore, I am pleased to see that leading tax economists focus exactly on the political economy dimension of tax reforms in today's discussion.

As you know I was Finance Minister of France for two years when the fiscal system of my country was substantially modified. **As a matter of fact I know pretty well the gap between tax reform on paper and tax reform in real life.**

I believe that the following aspects are important in this context:

Given the limited amount of political capital, governments are often not able to implement all those reforms that might be considered ideal or desirable from an economic perspective, and they must invest their capital wisely.

Along the same line, governments need to consider whether a 'big bang' or a step-wise implementation of reforms would be the best strategy. I am aware that there are many arguments in favour of packaging reforms. In practice, however, when such a 'big bang' seems unfeasible, sequencing

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initiatives can help to build support and address the concerns of those most affected by the different measures. This is to a large extent, by the way, the strategy that was adopted in France when I was Minister of Finance.

Sometimes, the aim of increased efficiency may be in opposition to what is politically feasible. The most desirable economic feature of a reform may not be the one that can be implemented easily from a political point of view.

I am convinced that it is important to hold on to the reforms taken and to ensure that they are not reversed. Even if one may not agree 100% with reforms undertaken by one's predecessors, credibility, predictability, and continuity of policy are crucial for a country's investment climate and confidence. This argument is particularly valid in the area of taxation.

Balancing efficiency and fairness

Let me turn to a point that I consider to be very important:

As already expressed, to successfully implement tax reforms, governments need to **seek a balance between efficiency, fairness and political feasibility.**

Efficiency is sometimes at odds with the desire for greater fairness. Whereas efficiency calls for a neutral tax system, equity may call for more redistributive elements in the tax system or for specific instruments to address the needs of vulnerable groups.

Take the example of a tax shift from labour to consumption. Such tax shifts can under some circumstances be shown to be beneficial for growth and employment and for society as a whole.

Tax shifts can – from the start – be targeted at low-income earners or low-skilled unemployed. As Minister for the Economy and Finance in France from 2012 to 2014, I was confronted with the crucial challenge of increasing employment, in particular of low-skilled workers. With the Ayrault government, we introduced the *credit d'impôt compétitivité emploi – CICE*, which became a key measure of the *pacte de compétitivité*. This corporate tax credit aimed to significantly reduce the cost of low-skilled labour, as it is calculated on the payroll of low-income earners. While this measure was partially financed by an increase of consumption taxes, it was from the beginning focused on the least well-off, balancing efficiency and fairness considerations.

Last: one important point I am sure you are very familiar with: the importance of data and simulation. It is fine to think theoretically on how to target reforms, but if you do not know who is going to be affected by a cut or a hike, you do tax reform under high uncertainty of the results – and political economy is vain. The government I was part of had some experience of that.

Precise knowledge is key. So stage one of tax reform is to give access to (anonymous) data to academics and experts so that they can compete in designing smart tax reforms well in advance.

As Finance Minister I modified the Tax Code to enable academics to works on tax data and France has now an open-licence online simulation engine able to perfectly simulate all components of our tax and benefits system – *Openfisca.fr*.

Now what is the role of the Commission in national tax reforms?

As Commissioner for Economic and Financial Affairs, Taxation and Customs, I have a different perspective on the tax reform efforts by Member States. Our analysis shows that several Member States ensured stable public finances and boosted growth by changing their tax structures and improving the efficiency of their systems.

What we see as well is that measures taken by Member States, for example when reducing labour taxation, often go in the right direction but are of limited ambition, given the size of the challenge faced.

In recent years, the Commission has actively supported Member States in the area of taxation, while recognising their competence for national tax policy.

We use several channels to do so:

The European Semester, the cycle of economic policy coordination leading to country-specific recommendations, is the most prominent one. Based on in-depth analysis, we identify which reforms could best help Member States boost growth, increase employment and achieve sustainable public finances. Tax reforms naturally have an important role to play. But again, with taxes, the devil lies in the details – and the details are for national governments to decide.

To focus attention on the most important reforms and to invest in them political capital, recommendations have been streamlined.

Another way in which the Commission supports tax reforms is through its ongoing dialogues with Member States, which includes the ECOFIN Council, where Finance Ministers meet on a regular basis. This dialogue allows Member States to share best practices among themselves and helps to identify 'do's' and 'don'ts'.

A good example is the area of labour taxation. The European Commission recommended that the Eurogroup organises thematic discussions on structural reforms with potentially large spillovers between Member States.

The Eurogroup has discussed the issue of labour taxation several times, establishing it as a reform priority, agreeing to common reform principles, and setting a benchmark to track progress.

But where our added value is the most important is probably in helping member states regain tax sovereignty in fighting efficiently again evasion and avoidance.

An EU dimension to tax policy

Clearly some tax policy challenges are more difficult for Member States to address in isolation. Think of tax evasion and tax avoidance. Uncoordinated national measures are being exploited by some companies to escape taxation in the EU, leading to significant revenue loss for Member States and a heavier tax burden for citizens.

The OECD has sought to address this issue through the Base Erosion and Profit Shifting project. But EU action is needed, in addition to action at global level, as the EU has unique characteristics, such as the Treaty Freedoms and an internal market with 28 different tax systems. This means we have our own priorities and objectives that need to be considered.

The crisis gave momentum for reforms at EU level, which would not have been possible before. Who would have thought that Member States would agree to exchange information on savings?

In June 2015, the Commission adopted the communication "A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action". The initiatives included in the Action Plan aim at tackling tax avoidance while securing sustainable revenues for Member States and strengthening the Single Market. While taking into account the necessity to reinforce the efficiency of the tax environment for businesses in the internal market, the key objective of this Action Plan is to ensure that companies are taxed where their profits are generated and cannot avoid paying their fair share of tax through aggressive tax planning.

The plan identifies five key areas for action: re-launching the Common Consolidated Corporate Tax Base initiative (or CCCTB), ensuring fair taxation where profits are generated, creating a better business environment, increasing transparency, and improving EU coordination.

Key to the action plan is the re-launch of the CCCTB, which would harmonise the tax base for multinationals operating across borders in the EU and – as a second step - allow businesses to consolidate their taxable profits across Member States. The CCCTB is a key building block in the agenda for fairness, transparency and a truly single fiscal market I mentioned earlier. It would make the internal market more competitive, as business would need to comply with just one set of tax rules and would allow them to offset profits in one Member State with losses in others. But it would also limit the opportunities for these companies to manipulate their tax position, thereby providing a holistic approach to combatting evasion within the EU.

Conclusions

Ladies and gentlemen, distinguished guests,

Today's presentations and discussions highlighted the political obstacles that tax reforms face and the specific strategies that can be used to overcome those obstacles. What is needed now is a large measure of political will – indeed political courage – to make tax reforms happen.

Thank you.