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Editorial

Going short in Euros?

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It seems likely that investment fund managers may consider whether they should go short in the Euro once it is introduced. A short-seller of Euros believes that the Euro will depreciate against other currencies like the US dollar and thus the short-seller would realize a gain on such a transaction. One of the important factors in the confidence of financial markets in the Euro is the development of the state budgets of the Euro-countries. Obviously, tax revenues play an important role in balancing the budget of a given state. Here the so-called tax competition between the states may affect the ability of states to collect a proper amount of taxes to balance the budget. The EC Commission believes that the tax competition between the Member States has resulted in Member States being unable to tax income from capital in a proper manner.

It seems to me that Member States that enter into tax competition, act as they are expected to act, considering the prevailing paradigm laid down in the EU Treaty. Herzig[1] has argued that the paradigm is in the first place based on the reasoning that the free flow of goods, employees, capital and services maximizes welfare in the Union. This principle is combined with the concept of subsidiarity, meaning that there shall be no interference of EC law and regulations into issues that can be handled best at national level. Hence tax competition perfectly fits the economic paradigm embedded in the Treaty.

In an extensive and well-documented article, Peter D. Enrich has analyzed the tax competition between the states in the US.[2] He concludes that there is no conclusive economic evidence that tax competition between the states in the US works,[3] that tax competition is a zero sum game for the US economy as a whole, that tax competition has negative effects for the individual states and that it reduces the level of comity and cooperation between the states. Still tax competition is a flourishing business in the US. Politics seem to explain best the existence of the phenomenon. In the first place, introducing tax incentives gives politicians the possibility to show that they take action in the interest of their voters. Doing something is, from the political perspective, always better than doing nothing. Furthermore, it is easier to spend money by giving tax breaks than first to collect taxes and then justify explicit subsidies. Finally, the business community seems to begin to take tax breaks for granted and expects that tax breaks will be granted in the case of new investment and location decisions.

Enrich argues that a legal remedy against excessive tax competition may be the application of the so-called Commerce Clause in the US constitution. The provision has however until now only been applied to protect out-of-state business against inner-state discriminatory treatment.

The US analysis shows remarkable parallels with the situation in Europe. With respect to employment and investment in Europe as a whole, tax competition between the Member States is a zero sum game. Also, the US Supreme Court in its decisions on the Commerce Clause and the European Court of Justice deciding on non-discrimination issues, could be characterized as twins. This is probably because in both instances these Courts are called upon by taxpayers seeking equal treatment - i.e. the same tax benefits - for inner-state tax purposes. No cases have been brought to the Supreme Court or the European Court to challenge tax competition as a barrier to fair competition between businesses. In Europe the provisions on State Aid may, however, be a hurdle to granting unjustified tax breaks to specific businesses but these provisions do not provide a general framework for the prevention of tax competition. The *ad hoc* character of the application of the State Aid provisions prevents this while at the same time there seems to be an unwritten rule that Member States do not contend the tax breaks given by other Member States in an open and conflicting manner via the State Aid provisions.

A major difference between the US and Europe is, however, that in the US, next to the state taxes, there is a federal income tax levied by the central government. In other words, the budget of the US Government is not dependent on state taxes that are the subject of tax competition but on the federal taxes. In Europe there is no 'backbone' of a European federal tax. European budgets depend on the taxes collected by the individual Member States. Consequently, tax competition in Europe does have a far greater impact on budgets of the Member States than the tax competition

1 Norbert Herzig, 'Wettbewerb der Systeme Steuerrecht im Europaischen Binnenmarkt, Band 19 Deutsche Steuerjuristische Gesellschaft, 1996, Dr O. Schmidt, Koln.

2 Peter D. Enrich, 'Saving the states from themselves: commerce clause constraints on state tax incentives for business', *Harvard Law Review*, vol. 110, no. 2, December 1996, pp. 378-468.

3 A reason could be that US state taxes are not as significant as other economic factors in deciding upon a business location.

between the states in the US. In other words, considering the prevailing paradigm in the EU Treaty and the lack of a Treaty framework to avoid the slashing of tax revenues, the fund manager mentioned earlier may consider short sales of the Euro against the US dollar. Such a development would be dramatic for European employment and welfare.