The Greek debt – a European story …

By Catherine Mathieu and Henri Sterdyniak

At end 2014, Greece's debt was 317 billion euros, or 176% of its GDP, up from 103% in 2007, despite debt relief of 107 billion in 2012[1]. This debt is the result of a triple blindness, on the part of: the financial markets, which lent to Greece until 2009, heedless of the unsustainable level of its public deficit (6.7% of GDP in 2007) and its trade deficit (10.4% of GDP in 2007); the Greek government and ruling elite who, thanks to the low interest rates permitted by its membership in the euro zone, allowed unbalanced growth, based on financial and real estate bubbles, corruption, poor governance, fraud and tax evasion; and Europe's institutions, which after the laxism of 2001-2007, imposed crushing, humiliating austerity programmes on the country, with the oversight of the troika, a strange threesome consisting of the International Monetary Fund (IMF), the European Central Bank (ECB) and the European Commission (EC). In the eyes of the troika, the austerity programmes were needed to cut the public deficit and debt and put the Greek economy on a path to growth. While the programmes did indeed help to reduce the public deficit (which was only about 2.5% of GDP in 2014, i.e. after excluding interest expenses, a surplus of around 0.5% of GDP), they have pushed up the ratio of debt to GDP, due to the collapse in the country's GDP, which is now 25% less than in 2008. Austerity has above all plunged Greece into economic and social distress, as is sadly illustrated in an unemployment rate of over 25% and a poverty rate of 36%.

The tree of Greek debt must not, however, hide the forest: from 2007 to 2014, the public debt of the OECD countries as a whole increased from 73% of GDP to 112%, reflecting profound imbalances in the global economy. Due to financial globalization, the victory of capital over labour and growing inequality, the developed countries need large public debts; these debts are generally not reimbursable, since reimbursement assumes that agents with a surplus agree to run deficits.

Take the example of Germany. It wants to maintain a large external surplus (7% of GDP), which weighs down its European partners and has contributed to an excessively strong euro. In order for Greece and other European countries to repay their public debts, they need to be able to export, especially to Germany; Germany would in turn have to accept an external deficit and thus greatly increase public spending and wages, which it does not want to do. The contradictory demands of the surplus countries (to maintain a surplus but be repaid) are leading the entire euro zone into depression. Fortunately for the European economy, neither France nor Italy is adhering strictly to its European commitments, while the UK is not subject to them.

Can we require Greece to continue to meet its European commitments, which have led to a deep depression? To reduce its debt to 60% of GDP within 20 years? The effort needed to do this depends on the difference between the interest rate paid on debt (1.9% in 2014) and the nominal rate of GDP growth (-1.2% in 2014). Even if Greece managed to accelerate its growth so that the growth rate equalled the interest rate for its loans, it would still have to turn over 6% of its GDP every year; this drain would unbalance the economy and put the brakes on growth. The Greek people cannot be asked to make further economic and social sacrifices.

If Greece were an emerging country, the solution would be obvious: a strong devaluation and default on the debt. The euro zone, on the contrary, cannot be maintained without solidarity between its members and without a turnabout in its economic policies. Europe cannot ask Greece's new government to maintain an austerity programme that has no prospects or to abandon its electoral programme and implement the failed policy negotiated by the previous government. A refusal to compromise would lead to the worst result: a showdown, a financial freeze on Greece, and then its withdrawal from the euro zone and perhaps the EU. The people would rightly feel that Europe is a straitjacket and that democratic votes don't count. On the other hand, it will be difficult for the northern European countries and the Commission to give up their demands: tight control of national fiscal policies, a reduction in public debts and deficits, conditionalities on aid, privatization policies and structural reforms.

Syriza's programme includes the restoration of social welfare and the public services as well as a decent standard of living for retirees and employees, but also, very clearly, tax reform, the fight against corruption and bad governance, and the search for a new development model based on the renovation of production and re-industrialization, driven by the State and a restored banking sector, based on public and private investment. This is an ambitious path that presupposes a fight against greed and the inertia of the dominant classes by mobilizing the whole of society, but it is the only future with promise.

The only solution is a compromise that would open the door to a new policy in Europe. Let's distinguish the Greek question from the European question. Europe's institutions must agree to negotiate a restructuring of Greek debt. This 317 billion euro debt is now held as follows: 32 billion by the IMF, and 223 billion by the ECB, the European Financial Stability Facility, and the other Member States, i.e. 80% by public institutions. This enabled the private sector to shed Greek debt, but it has not helped the Greek economy. Greece already benefits from low interest rates and lengthy repayment deadlines [2]. Given the low level of current interest rates and the hunger of financial investors for the risk-free sovereign debt of most Member States, there is no reason for a default on Greek debt; it simply needs to be restructured and secured. We must avoid a situation where every year Greece is in the position of having to repay and refinance an excessive amount of debt, and thus finds itself at the mercy of the capital markets or new negotiations with the troika. Greece needs a long-term agreement based on mutual trust.

Europe should give the Greek people time for their economy to recover. Greece's debt needs to be made sustainable by converting it into very long-term secured debt, possibly confined within the European Stability Mechanism, so that it is sheltered from speculation. This debt could be financed by Eurobonds with very low rates (0.5% at 10 years, or even slightly negative rates by issuing securities indexed to inflation). European taxpayers would thus not be saddled with the burden, and the Greek debt load would be acceptable. It is Greek economic growth that will make it possible to cut the ratio of debt to GDP. The reimbursement should be limited and, as proposed by Greece, depend on growth (e.g. be zero when the volume of growth is less than 2%, and then 0.25 GDP point per additional point of growth). The agreements with Greece should be reviewed to allow the new government to implement its programme for social and production renewal. Two key points must guide the negotiations: that responsibility for the situation is shared between Greece and Europe, that each must bear its share of the burden (the banks have already undergone a partial default); and that Greece must be helped to recover from its deep depression, which means support for consumption in the short term, and in the medium term stimulating and financing the country's productive renewal.

France should support Syriza's proposal for a European conference on debt, because the problem is not just Greek. The Greek experience merely exemplifies the structural problems with Europe's economic governance and the challenges facing all the Member States. This governance needs to be overhauled in order to overcome the economic, social and political crisis gripping the euro zone. The turning point represented by the Juncker Plan must be given resolute support (investment support of 315 billion euros in three years), as must the ECB’s quantitative easing programme (1140 billion in 18 months).

The public debts of the euro zone countries must be guaranteed by the ECB and all the Member States. To absorb them, the ECB must keep long-term rates well below the rate of growth, which will require taxing financial activities and controlling the orientation of bank loans to prevent the rise of speculative bubbles. Instead of cutting public and social welfare spending, Europe must coordinate the fight against tax competition and tax evasion by the wealthy and by multinational firms. The unsustainable fiscal straitjacket imposed by the Stability Pact and the European fiscal treaty must be replaced by the coordination of economic policies aimed at full employment and resolving imbalances between euro zone countries. Finally, Europe must propose a strategy for recovery from the crisis based on boosting domestic demand in the surplus countries, coordinating wage policies, and supporting investments that prepare the ecological and social transition. The challenge here is crucial. We need to rethink the way economic policies are organized in Europe in order to allow countries to conduct policies that are different and autonomous, but coordinated. This is the only way the euro zone can survive and prosper.

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[1] More than half of which was used by the Greek state to secure the country’s banking system.

[2] Moreover, the ECB Member states are repaying it any gains that they make on Greek bonds.

Who has the best playing field for tax competition: the United States or the European Union?

By Sarah Guillou

Two recent events demonstrate the differences in the American and European views on tax competition. First was the case of Boeing, which the European Union (EU) has brought before the World Trade Organization (WTO). The EU is challenging the tax incentives offered by the State of Washington to the American aircraft maker. Then there is the European Commission's investigation of Luxembourg's tax provisions that benefit Amazon, the Internet retailer. Boeing and Amazon both make massive use of tax competition. While this is widespread and accepted in the United States, it is being increasingly questioned in the EU, and even excluded by law if it is classified as illegal State aid.

In the Boeing affair, in December 2014 the EU filed a request for consultations with the WTO regarding the tax subsidies paid by the State of Washington for the manufacture of the new Boeing 777X. This aid would amount to 8.7 billion dollars for assembly in the State. This programme was set up in November 2013 by the State of Washington, and the governor has now decided to extend it until 2040! The incentives are conditioned on the use of local products, i.e. the aid is linked "to local content requirements ". However, these requirements are contrary to the WTO Agreement on Subsidies and Countervailing Measures. We are not going to discuss here the EU's complaint, which is awaiting a response from the US, and which is part of an ongoing dispute between Boeing and EADS about their respective public subsidies. This case, however, offers an opportunity to take a look at the intensity of tax competition that exists between the various States in the US.

While the US, like the EU, is concerned with non-discrimination, which is set out in the doctrine of the Commerce Clause of the US Constitution, in practice it has been difficult for case law, which performs an *a posteriori* control, to provide a definition of discrimination that makes it possible to prevent discriminatory regulations. The result has been that the American States are free to offer subsidies and tax breaks to companies, or sometimes specific companies, to attract investment and jobs. Recall that in Europe, controls on State aid are performed *a priori* and that granting subsidies to any specific companies is totally excluded (see Guillou, 2014, OFCE blog). In the US, Boeing is a major player in this tax competition.

An American research center "goodjobsfirst", which tracks the aid and subsidies granted to companies by public institutions, showed that a mere 965 companies received 75% of all aid. It is Boeing that receives the most aid. This comes mainly from two States, Washington and South Carolina, with numerous subsidies (130 agreements) from all over the United States. The combination of all the aid brought to light amounts to 13 billion dollars. Boeing comes far ahead of all other companies, as second-place Alcoa receives less than half as much (5.6 billion dollars). Another study found that 22 States competed to host the production of the new 777X airliner, but Boeing ultimately decided to stay in the Seattle area and entered a 16-year tax agreement with the State of Washington that is estimated to be worth more than 8.7 billion dollars, the largest tax break in the United States. Business lobbying is much more common in the United States than in Europe, which explains much of the competition between States to attract business. While the United States has complained of foreign tax competition (especially vis-à-vis Ireland), it accepts this completely on its own territory. This is not the prevailing position in the EU, of course, as the EU is not fiscally integrated.

Indeed, in Europe, tax harmonization is not yet on the agenda. But tax competition is being increasingly debated. This has not been in vain, as this pushed Ireland to abandon its “double Irish” system that allowed certain companies located in Ireland to be taxed in tax havens. Companies taking part in this tax scheme began the process of withdrawal in January 2015. While differentiated taxation is still accepted in Europe, excessive tax competition has been considered intolerable in the common market. When companies’ tax optimization strategies come together with national strategies to attract jobs and investment, the ingenuity of the tax authorities becomes a threat to the common market. What is most worrying is the legitimization of the avoidance of common tax rules.

European controls on State aid act as a powerful guardian over the use of public resources and on non-discrimination in the European market. These controls could well become an instrument in the fight against tax “loopholes”, vulnerabilities in the tax system that result in significant losses of public resources. The case against Luxembourg concerns its system of “tax rulings”. The tax ruling is a procedure whereby a State negotiates with a company about its future tax status. This procedure, which has been called the “marketing of State sovereignty”, is widespread in Luxembourg and was brought to light by a recent investigative report published in November 2014 (*Le Monde*), which shows that Luxembourg is not the only country to use these “tax rulings”.

Luxembourg attracts a large number of multinational firms that choose the location of their European headquarters based on tax optimization. It is the EU country with the lowest percentage of GDP (the production of residents) out of GNP (domestic production): this figure was only 64% in 2013, against just over 100% for France and Germany. In other words, Luxembourg lost more than one-third of its national income once the payment of income to resident foreign companies was taken into account (net of income received). This reveals the fiscal opportunism of the numerous multinationals located in Luxembourg, for which the local market is clearly not a target.

In this case, Luxembourg has granted Amazon a valuation of its transfer pricing that the European Commission (EC) considers overestimated, which thus leads to underestimating the tax base (see the recently released EC decision).

Transfer prices are the prices of the goods and services traded between subsidiaries of the same corporation. These exchanges should theoretically be valued at market prices, that is to say, the price that would be paid by a company that is not a subsidiary of the corporation. The way these prices are decided may change the amount of a subsidiary's purchases and revenues, and thus its profits. The logic of the corporation is to minimize profits where tax rates are high and shift them to where rates are low. It is not so much the price of goods that are manipulated as the price of intangible assets such as patents, copyrights or other intellectual property (trademarks, logos, etc.). Multinationals that hold intangible capital, such as the giants of the Silicon Valley, are the ones that most commonly engage in this type of manipulation.

One way to prevent the manipulation of transfer pricing in Europe would be to make it obligatory to calculate a common consolidated corporate tax base. This is the purpose of the draft CCCTB directive from 2011, which is still under discussion. Trade-offs between the various European countries would be pointless, as the tax base would be consolidated and then distributed among the member States based on a formula that takes into account fixed assets, labour and sales. The States would retain control of their tax rate on corporations. It is expected that this common base scheme would be optional. It is not certain that this would suffice to get the directive passed, as in fiscal matters this demands a unanimous vote whereas, for the moment, there is a great deal of disagreement.

On the other side of the Atlantic, the United States has a consolidated tax base system at the national level and a common federal tax rate on corporations. But local taxes, which can vary between 1% and 12%, are generally deductible from the federal tax calculation. The issue of transfer pricing between subsidiaries in different States may therefore also arise. And this is especially so, given that the local tax rate on profits is subtracted from the various tax credits awarded to certain companies.

The outcome of the investigation into Luxembourg and Amazon will be important for the future of the CCCTB Directive, in particular the version that affects only digital businesses. If the day has not yet come when the EU rules that "banking secrecy is a disguised form of subsidy" (G. Zucman, The hidden wealth of nations), the investigation into Amazon indicates that the EU is beginning to put some limits on tax competition that could soon make American taxpayers jealous.