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Choosing our Story of Fiscal Interdependence

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There is a striking distance between the description of tax competition stemming from the economic models of the phenomenon and what we may indeed reconstruct as the international tax interdependence of the last forty years. This paper aims at characterizing this gap and inferring its consequences on the usefulness for policy guidance of the conventional efficiency criterion. I will argue that the equilibrium based approach of conventional economic models is not well suited for the phenomenon at hand. The essentially static narrative should be replaced by a dynamic story presenting international fiscal interdependence as a resolutely complex adaptive system. An important consequence of this shift is the disappearance of the hope of finding a unique normative criterion to perform policy prescriptions.

Following Axelrod and Cohen, I define a complex adaptive system as "a system contain[ing] agents or populations that *seek* to adapt"[1]. A key point about such a system is that, "as agents adjust to their experience by revising their strategies, they are constantly changing the context in which other agents are trying to adapt". The consequences of some actions are thus hardly predictable. A complex adaptive system does not reach a point of rest, an equilibrium, because agents adapting to each other "co-evolve" in a potentially endless process.

We thus have two narratives of fiscal interdependence that I will call the 'economic story' and the 'dynamic story'. These two narratives offer radically divergent characterization of tax interdependence. (i) The economic story assumes tax competition to be a simple resultant of the mobility of capital. The dynamic story insists that it is embedded in a peculiar institutional regime composed, for instance, of thousands of bilateral treaties. A modification of this regime transforms the nature of tax competition. (ii) The former assigns a minimal set of strategies to agents, while the latter maintains that the system is driven by innovative strategies which are, by definition, not summarized in the simple choice variables of economic models. (iii) While one focuses on a final stage, a point of rest or equilibrium, the other is describing an endless process of mutual adaptation or co-evolution. (iv) When they reach normative conclusions, the economic story relies on the criterion of efficiency. However, efficiency has a different meaning from one economic model to the other. In the dynamic story, the single criterion approach is

1 Axelrod, R. M. and M. D. Cohen, 1999, *Harnessing complexity : organizational implications of a scientific frontier* (Free Press, New York) 7-8.

rejected to the profit of a multi-dimensional evaluation. The dynamic story also points to the particular importance of the learning and adaptive potential of a system.

By the criterion of theoretical simplicity, the economic story far outweighs the dynamic story. However, a theory should never be preferred on the ground of theoretical simplicity if it is found highly ineffective in achieving its goal. The goal being adequate policy guidance in the present case, my paper aims at demonstrating that, due in fact to its simplistic form and to its related problematic empirical validation, the economic story does not even come close to this target. As we need a narrative to guide us in our political choices, a dynamic story should take the lead.