

Taxing Capital in the Single Market

The Continuing Struggle Over European Tax Harmonization

Henk Overbeek

Vrije Universiteit Amsterdam

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Henk Overbeek
Department of Political Science
Vrije Universiteit Amsterdam
De Boelelaan 1081
NL - 1081 HV Amsterdam
Tel. +31 20 598 6894
<hw.overbeek@fsw.vu.nl>

1. Introduction

This paper is part of a larger project on socio-economic governance in the European Union. The ambition of that project is to interrogate in a systematic fashion the European neo-liberal project against the background of the ongoing globalising thrust in the world political economy.

Whereas critical studies of European integration have in recent years tended to concentrate on the disciplinary macro dimensions primarily of monetary union, the success of the neo-liberal project cannot be adequately understood unless more systematic attention is paid to an analysis of the ‘normalising’ impact of the Single Market project, including the liberalisation of capital flows for which monetary union was considered a prerequisite. One of the major obstacles to the free mobility of capital in the Single Market, according to the European Commission, is the absence of a harmonized system of corporate taxation (European Commission 2001).

This paper attempts to make sense of the political struggle that has taken place over the past few years (and continues to be waged) regarding the development of a common business taxation regime in the European Union.

The structure of the paper is as follows. Section two looks at the nature of the European integration project since the adoption of the Single European Act to understand the context in which the struggle over corporate tax harmonization has taken place. Section three then analyses the development of the struggle over tax harmonization and in particular highlights some of the contradictions revealed in the course of this struggle. In section four, we turn briefly to some empirical data to ascertain the validity of some of the key arguments used by the protagonists in the struggle: is there tax competition between the EU states, and what are the effects of this competition? Finally, section 5 attempts to draw some tentative conclusions.

2. The Nature of Neo-Liberal Europe¹

The EU political system is a system of multilevel governance (cf. Marks, Hooghe, Blank 1996, Hix 1999). However theories of multilevel governance (MLG) in Europe so far have been marred by a strong institutionalist bias, which ignores the embeddedness of the institutional architecture in the force-field of social, economic, political and ideological interests and conflicts as configured by the contemporary make-up of the capitalist mode of production. The EU is a new form of statehood (see Demirovic 2000 and Ziltener 1999, 2000), in which what we traditionally understand by 'state' is being expanded to encompass not only traditional 'government' but also newly emerging forms of 'governance'. This neo-liberal governance is characterised by new combinations of increasingly informal regulation in networks comprising national government representatives, sub-national authorities, supra-national bodies, and private non-governmental organisations (see also Overbeek 2004).

A crucial dimension of this new form of statehood is its *transnationality*. Much space has been devoted in numerous writings to discuss the distinction between the international and the global, or between the international economy and the world economy, but one is hard pressed to find a good definition of *transnational*. 'Transnational' must not be juxtaposed to 'national' (as if it is synonymous to either international or supranational). Rather, the notion of *simultaneity* is crucial to an understanding of what is specifically transnational. Transnational processes are those that take place simultaneously in subnational, national and international arenas, and "in relative disregard of [international] boundaries" (Huntington 1991, 212). Their dynamic is not fundamentally defined by the existence of national boundaries (although these do exist and continue to be important, indeed their particular configuration can play an important role in the transnational dynamic). Analogously, transnational *actors* are constituted and operative in a social space that extends simultaneously beyond and within 'national boundaries' which still exist but have at best a second order relevance when understanding their behaviour.²

¹ This section is based on van Apeldoorn, Overbeek and Ryner 2003.

² Huntington holds that agencies of national governments are to be considered transnational organisations if they operate 'in relative disregard of borders'. This is nonsensical. Precisely that characteristic which according to Huntington defines the 'transnational' in transnational activity must also be applied to the actors itself: a transnational agent (organization, social class, even ideology) is one that is *constituted* in a space *beyond* (i.e. not

Very concretely, European integration must be situated in the context of transatlantic class formation, not as an autonomous process as is so often the case in mainstream theories of European integration. The foundation, development, and periodic intensification of European integration are fundamentally moments of the expansion of the transnational capitalist political economy which has been in uneven formation since the Glorious Revolution, centred first around Great Britain and later around the United States: a *Pax Anglo-Saxonica* of a 'Lockean heartland' (van der Pijl 1989). This process itself, although its rhythm is dictated up to a point by the dynamic of American capital, is contradictory. The transatlantic linkage fundamentally influences European integration, but European integration is not simply subject to or determined by American control.³

The beginnings of the second era of European integration (the transition to the neo-liberal phase or to the 'competition state mode' (Ziltener 1999) can be traced back to the mid-1970s, a period of organic crisis in the post-war order. One essential dimension of this crisis was the derailment of the virtuous circle of Fordism and the concomitant decline of Keynesianism. As need not be detailed here, the response of heartland capital consisted in a dual offensive, one of restructuring at home and redeployment of capital abroad where accumulation conditions were better. This crisis was confounded by the decline of American hegemony - highlighted by the monetary crisis of the years 1967-1973, the Middle East war and the oil crisis, and the US defeat in Vietnam. These crisis tendencies set in motion a rethinking in ruling European circles of the transatlantic relationship.

defined in essence by) national borders. Both the Dutch Federation of the Metal Industry (FME) and the European Roundtable of Industrialists (ERT) are active in lobbying in Brussels (and elsewhere). Yet, the FME's membership is defined by the boundaries of the Dutch national state making it a national organisation, whereas the ERT is constituted on the basis of criteria that disregard the boundaries of the European nation states, making it a true transnational organisation.

³ "Although the immediate origin of transnational capitalism is the oligopolistic corporate sector of the American economy (...) its American 'national' character has been gradually eroded as similar dynamic cores (...) have emerged in (...) Europe and Japan (...). The original American drive to reorganize capitalism has therefore been transformed, becoming a transnational drive, which is in turn penetrating and affecting American society itself, as well as others." (Sunkel and Fuenzalida 1991, 335).

The first tangible manifestation of this is the foundation of the European Monetary System by Giscard d'Estaing and Schmidt, creating a momentum that by 1984 builds up to an 'extended relaunch of European integration' (culminating in the adoption of the single European Act and the Europe 1992 programme). By the early 1980s leading European multinational corporations, organised in the European Roundtable of Industrialists, were able to influence these developments decisively (cf. Holman 1992).

Initially, the strategic orientation of the ERT was neo-mercantilist in the sense that their main objective was to acquire the support from stronger European institutions in their struggle with American and especially Japanese competitors. By the early 1990s however the process of restructuring of European capital is so far advanced that the orientation of the ERT becomes outright neo-liberal. The European integration project becomes primarily one of what has become known as 'open regionalism', the combination of liberalisation and deregulation in a regional context, and open to a globalising world economy. The institutional arrangements within the European Union are increasingly geared towards these goals, and the initial tendencies towards something akin to 'Euro-Keynesianism' under the first Delors Presidency have all but disappeared (cf. van Apeldoorn 2000, 2001).

In the age of neo-liberal 'globalisation' since the end of the Cold War we can discern three distinct but interlocked dimensions to this process ongoing process: the strengthening of capital's freedom to accumulate, the re-configuration of boundaries between 'Lockean' and 'Hobbesian' spheres within the European space, and the re-construction of 'statehood' in the European Union. The aspect of freeing up capital movements is of course first of all the central objective of the completion of the Internal Market and the establishment of Economic and Monetary Union. The Internal Market project hinges on 'competitive deregulation', the EMU project on 'competitive austerity' (cf. Bieling and Steinhilber 2001, 110). Together, these two projects establish what we might see as the Constitution of neo-liberal Europe, subordinating economic and political actors (including the state) alike to the norms and rules of a globalising 'market civilisation' (cf. Gill 1995; also Gill 2001).

Likewise, Eastern enlargement of the European Union is a cornerstone of the European neo-liberal order being constructed (see Bieler 2000 and Holman 2001, 2004). The accession process in fact, by means of the so-called Copenhagen criteria and the convergence criteria for EMU, gives the European economic constitution force of law in countries that are still in some cases many years from possible membership.

3. Internationalization and business taxation in Europe

Increased mobility of capital has repercussions for the capacity of states to safeguard their revenue base. This issue is not a new one. During the late 19th and early 20th centuries states were confronted for the first time with the impact of increased capital mobility on their tax systems. On the one hand, states began to introduce various schemes of direct taxation to finance their growing expenditures, while on the other hand capital internationalized rapidly (finance in particular, but productive capital as well). This brought to the fore the problem of *double taxation*, i.e. the same income being taxed by the country of residence as well as by the host country (where the income was being generated). Business pressure, through the International Chamber of Commerce in Paris, put the issue on the agenda of the Fiscal Committee of the League of Nations. In the early 1920s the Fiscal Committee commissioned a report, funded by the Rockefeller Foundation, to propose action (Picciotto 1991, 54-55). The report considered two alternative ways of approaching the problem, *formula apportionment* and the *arm's length principle*. Formula apportionment entails the shared taxation of the total profits of a corporation, with a formula stipulating the respective shares for home and host (or capital exporting and capital importing) countries' governments.⁴ This approach was rejected in the report because it posed too many politically sensitive issues and would require a multilateral international agreement. The arm's length principle means that the activities by subsidiaries of corporations are considered essentially as separate businesses to be taxed by the host government. This principle thus requires negotiations between corporate officials and host government bureaucrats.

⁴ Formula apportionment is the method used within the United States to decide on the taxation of corporations active in several states.

This approach has become the basis for the post-World War II international corporate taxation regime (Picciotto 1991, 55).

The new system was initiated with the wartime tax treaty concluded between the United States and the United Kingdom. This became the model after which a rapidly expanding network of bilateral taxation treaties was erected, primarily between and among the US, the UK, the English-speaking Commonwealth countries, and the major West European states. The co-ordination of this system, based on intergovernmental bilateralism mixed with the informal involvement of corporate lobby groups, was eventually taken up by the Fiscal Committee of the OECD (Braithwaite & Drahos 2000, 96-97). The structure of this system in many ways resembles and complements the structures of the Lockean heartland created in the second part of the nineteenth century in the form of the old Commonwealth and its symbiosis with the United States (cf. Van der Pijl 1989, 1998).

Tax Competition and Tax Harmonization in the EU

As a result of the decisions in the inter-war period and their subsequent elaboration after 1945, the arm's length principle was also the principle governing corporate taxes in Western Europe when the Treaty of Rome came into force in 1958. This would remain mostly uncontested until the advent of the Single Market.

Harmonization of taxation in the EU remained restricted to the levy of indirect taxation, primarily the value-added tax, which was harmonized in 1977 (Grahl and Teague 1990, 35-37). In 1992 agreement was reached (in the context of the completion of the Internal Market) on the establishment of a 15 % minimum VAT rate as well as on the harmonization of various excise rates, including the abolishment per 1 July 1999 of intra-EU duty free sales (Dinan 1999, 364-5).

It was not until 1990 that the implementation of the Single Market started to have an impact on the taxation of corporate profit. In that year an agreement was reached on a common system of taxation applicable to mergers, divisions and transfers of shares involving companies of different member states as well as to parent companies and subsidiaries of different countries.

Nevertheless, the continued existence of differences in systems of corporate taxation within the EU seriously complicates cross-border EU mergers (Chown 2000, 106-7).

The issue of tax harmonization was brought to life again by two documents published by the Commission in 1996 in which it surveyed the development of tax systems in the EU and discussed a number of possible ways to increase co-operation in the taxation field (European Commission 1996a, 1996b). Two issues were addressed. On the one hand, and this has since proven to be the more persistent issue, the Commission notes that the mobility of capital in the Internal Market is obstructed by the existence of multiple tax jurisdictions which complicate the cross-border activities of Europe's multinational companies. On the other hand, the Commission also has to respond to the increasing fear among certain (mostly social-democratic) governments that the Single Market will lead to intensified tax competition. In December of 1997, the EU finance ministers agree on a number of measures including the principles of a non-binding and restricted 'code of conduct' for tax policy to be drawn up by Internal Market Commissioner Mario Monti (European Commission 1997).

This second debate has been stimulated in large measure by the expected impact of monetary union. The EMU and its Stability Pact impose important constraints on the fiscal autonomy of member states' governments. The most important effect of this is the effective rejection of Keynesianism. There are strong *pro-cyclical* mechanisms built into the system that may even require that governments *raise* taxes during a recession (Levitt & Lord 2000, 146, 155; see also Frieden, Gros & Jones 1998, and Wunder 1999). One might imagine that countries such as Spain, Belgium and Italy (with their high national debt and/or unemployment rates) are particularly vulnerable to these mechanisms. In the course of 1998, the new German Minister of Finance Oskar Lafontaine addressed these issues under the heading of 'unfair tax competition'. He feared a shift in the tax burden from mobile to fixed assets, from capital to labor and from high incomes to low incomes⁵, and saw in these tendencies an argument to propose the gradual harmonization of taxation policy in the European Union.

⁵ His fears were confirmed by data from the European Commission: the share in the total tax take of taxes on capital and self-employed labour declined from around 43% in 1980 to about 35% in 1996. In the same period, the share of taxes on wages and salaries has increased from 35% to 43% (*The Economist* 5/12/98). A study of the Institute for Fiscal Studies for Britain corroborated these findings: during the 1980s there had been a shift from direct to indirect

His main opponents based themselves on neo-liberal arguments stating that tax competition is a good thing because it lowers tax rates. When faced with tax evasion and erosion of the tax base, governments should not tighten their tax rules and increase their rates, but instead should lower their rates. This would result in a more competitive tax climate and would eventually raise instead of lower the total tax take (e.g. Bracewell-Milnes 1999; Ellis 1999).

Lafontaine and his French colleague Strauss-Kahn proposed to pursue his objectives by extending voting by qualified majority (QMV) in the EU Council of Ministers to issues of taxation. They argued that tax rates, and particularly corporate tax rates, vary too widely and are used too often by governments to lure foreign investors, thus both eroding employment and undermining the capacity of other (neighboring) national governments to raise revenue.⁶ The proposals, and Lafontaine with it, were soon removed from the political arena after having been met with very broad disagreement. Since Lafontaine's defeat no leading European statesman has dared to propose quite the same steps. In the agreed so-called European Constitutional Treaty, the national veto with respect to taxation policy has been preserved.

Nevertheless, the issue of tax competition in the EU remained on the agenda. The detailed 'Monti package' containing a code of conduct was eventually presented in December 1998. It included a voluntary code of conduct on business taxation aimed at eliminating 'unfair' tax competition, as well as the proposal for a directive imposing a minimum 20% withholding tax on income from savings and investment accompanied by a proposal to eliminate withholding taxes on payments between associated companies of different member states (*Financial Times*, 3 December 1998).

taxation, resulting in gains for those with high incomes and losses for those at the bottom of the income distribution (Giles and Johnson 1994, 21).

⁶ This position was supported by the publication of a survey commissioned by the Dutch government showing that in practice almost all European governments were putting the neo-liberal logic of lowering effective corporate tax rates into practice (Ministry of Finance 1999). The deviation of effective corporate tax rates from statutory rates was found to vary from 1.88 percentage points in France and 3.2 % in the Netherlands to 11.5 % in Germany, 15% in Italy, 19 % in Belgium and over 22% in Portugal (Buijink, Janssen & Schols 1999).

In the course of the year 2000, nearly all member states decided to introduce tax cuts or were preparing decisions to that effect. The trend gained such momentum that one may wonder whether it is sustainable. Budget deficits are approaching zero, but in most countries the underlying budget balance (adjusted for the economic cycle) is increasingly negative (i.e. corrected deficits are going up) which raises a question about the longer-term sustainability of the tax-cut habit (*Financial Times*, 14 September 2000).

In the run-up to the December 2000 Summit, the Commission repeated its push for further harmonization (Commission européenne 2000). Commissioner Bolkestein advocated further tax co-operation, explaining that four concerns are at the bottom of this drive. These are the erosion of tax bases, the need to remove fiscal barriers to full factor mobility, the need to make tax systems more employment friendly, and the infringement through fiscal means of state aid rules (*The Key* 12, July 2000). However, after the failure in Nice in December 2000 to reach agreement on extended qualified majority voting for certain fiscal topics, the Commission had to settle temporarily for a pragmatic course concentrating on the practical issues surrounding the completion of the internal market (*Financial Times*, 24 January 2001).

The deadlock resulting from Nice (and confirmed later in the final text of the Constitutional Treaty) has ironic traits. The British government (supported by among other the Irish and the Austrians as well as, later, by some of the new member states) has blocked progress in the Europeanization of tax policy primarily because of the fear that such progress would follow the lines advocated by the French and the German governments aimed at imposing minimum rates of corporate taxation, if not the elimination of all tax competition (which had brought the Irish such enormous advantages). But by blocking any European decision-making in the area of corporate taxation, it has also blocked progress in eliminating the fiscal obstacles to creating a 'level playing field' for cross-border investment activity by transnational corporations.

The European Commission has repeatedly attempted to unlock this impasse. In 2001 it produced a *Communication* detailing a strategy to eliminate the fiscal obstacles to capital mobility in the Internal Market without compromising national sovereignty in setting tax rates. It begins by

pointing out that tax rate differentials are more effective than tax base differentials in the competition game, and that it will consider the level of taxation a matter for the member states. However, it argues that the differences in tax base⁷ must be eliminated: business cannot operate freely in the Single Market and the EU cannot hope to achieve its ambitions to surpass the US as the world's most dynamic economy (its "Lisbon goals") unless all fiscal obstacles are removed. The Commission proposals were applauded by the *European Roundtable of Industrialists* (ERT) which argued that "... consolidation of corporate tax bases in the EU should be the main strategy towards a, tax-wise, fully functioning Internal Market" (ERT 2001). The most comprehensive statement to date by the Commission repeats these points, adding that the creation of the European Company Statute from 2003 and the application of the new international accounting standards from 2005 both lend a new urgency to its proposals (European Commission 2003). The Commission argues that the adoption of a common consolidated company tax base (CCTB) is the only way to achieve its objectives. It states further that political obstacles prevent it from implementing a CCTB, but that if the Member States do not agree on some way of implementing a CCTB, they will be forced by the European Court of Justice (ECJ)⁸, which is considering a number of key cases (EC 2003, 4-6). It then ends by identifying the Nice Treaty "enhanced cooperation" procedure as a possible way of moving forward (EC 2003, 27; see also EC 2004).⁹

The reference to the role of the ECJ merits some separate attention. A first ruling in effect supporting harmonization of corporate taxation in the EU was delivered in October 1999. In a proceeding against the German federal government started by the French chemical conglomerate *Saint-Gobain*, the ECJ ruled that Germany may not discriminate (in terms of applying different tax regimes) between a Saint-Gobain branch (of the French parent company) and a Saint-Gobain subsidiary incorporated in Germany (*Financial Times*, 26 October 1999). The potential implications of this ruling may be momentous and the occasion underscored the importance of

⁷ The 'tax system' refers to the types of taxes to be levied (income tax, capital gains tax, VAT, etc.). The 'tax base' refers to the specific sets of goods, services, elements of income, etc. to which each of these taxes apply (is interest income from savings taxed under the income tax or not, are foodstuffs subject to VAT or not, etc.).

⁸ See below for more detail.

⁹ The Commission seems to be unaware (or deliberately forgetful) about the legal problems such a strategy might incur: any attempt by a limited number of member states to introduce among themselves a consolidated tax base regime will be found in violation of the non-discrimination clauses of the Single European Act as well as of the provisions of the existing bilateral tax treaties with non-participating member-states to which they remain bound (as is rightly pointed out by McClure 2004).

the ECJ in extending the reach of Community law and in reducing the scope for member state autonomy (cf. Wallace and Wallace 1996, 61-63). Subsequent cases, still pending at the time of writing, may be expected to force the hand of member state governments so far unwilling to agree to formal tax cooperation. The case of Marks & Spencer against the British government (where M&S demands that it can write off losses made by its French subsidiary on the same basis as if they were incurred in Britain) is the potentially most far-reaching in this respect (see reporting in *The Economist* (28 August 2004 and again 5 February 2005) and the *Financial Times* (2 February 2005)).

4. Tax Competition in the EU

In this section, we will briefly consider to what extent the claims about tax competition in the EU are justified, and what some of the implications seem to be.

In the context of globalization, governments are commonly assumed to confront a host of problems with respect to taxation, all of them potentially undermining their capacity to maintain both their tax bases and their tax rates. In the end, it is widely assumed, states will be unable to generate sufficient revenue to finance their burgeoning welfare systems and defense commitments:

“Tax competition has become a fact of life for many countries and the net effect is or will be a reduction in tax revenue for many countries and a forced change in the structure of their tax systems” (Tanzi 1998, 341).

Some of the problems which globalization is said to cause for governments in this respect (*fiscal termites* in the words of Vito Tanzi), and which EU member state governments also face in the context of the completion of the Single Market program, are:¹⁰

¹⁰ These are the most important ‘termites’ cited in, amongst others, Braithwaite & Drahos 2000, 88-142; Chavagneux & Palan 1999; *The Economist* 29-01-00 (‘Survey on Globalisation and Tax’); Ganghof 1999; Oxfam n.d.; Palan & Abbott 1996, 166-183; Palan 1998; Scholte 2000, 77; and Tanzi 1998, 2000.

- Locating economic activity (production) in low-tax countries or tax-exempt zones (Free Production Zones, Special Economic Zones etc.);
- ‘Transfer pricing’ by transnational corporations, i.e. the shifts of profits to low-tax jurisdictions and losses to high-tax ones;
- Tax deferral, i.e. the creation of ‘base companies’ in low-tax jurisdictions to ‘park’ undistributed profits;
- Increased activities by highly skilled individuals (especially in the new service industries) outside their ‘home’ countries and thus out of reach of their own income tax authorities;
- Increased travel by individuals who do their shopping (especially for expensive luxury items) in low-tax shopping centers (sales tax evasion);
- The growth of off-shore financial centers and tax havens (with an estimated annual turnover of some US \$ 5 trillion) contributing to the elusiveness of financial capital and skills;
- The development of new financial instruments (derivatives, hedge funds etc.) which further help to obscure the origin of financial gains;
- Growth of electronic commerce and electronic money, making it much harder to ascertain the size of the profits in question and to trace the identity of the profit maker.

One issue in particular interests us here: the issue of competition between EU states in setting the rates of corporate taxes. The Dutch study quoted above in footnote 6 provides us with a starting point (Buijink, Janssen and Schols 1999). It shows that for the 15 EU member states, between 1991 and 1996, there is some evidence of a downward trend, but it is very modest: the unweighted average of statutory tax rates for retained profits goes down from 39.8% to 37.6%. What is much more important, however, is the disparity between statutory rates and effective rates of corporate taxation. Here the study reveals that some countries show an enormous gap between nominal and effective tax rates (sometimes more than 50 %). This provides a strong indication for the occurrence of tax competition. The study was however unable to provide information regarding the development over time of both statutory and effective rates of corporate taxation. A very recent survey provides convincing evidence of a downward trend of statutory rates as well as of effective tax rates (Griffith and Klemm 2004). Between 1982 and 2003, average statutory tax rates in the OECD countries fell from some 48% to below 35% (with the gap between the highest and the lowest rates narrowing considerably (*idem*, p. 8). Effective

tax rates for profitable projects declined from on average approximately 45% in 1982 to around 34% in 2003. Many studies (Griffith and Klemm 2004, but also for instance De Mooij n.d. and EC 2001) conclude from these trends: “If capital becomes more mobile and the EU fails to coordinate, tax competition will put a severe strain on corporate tax policy and probably even on the effective taxation of capital income more generally.”(De Mooij n.d., 19).

In the literature, we find a range of claims detailing the expected effects of this type of tax competition. We are warned of:

- ‘tax base migration’ (Tanzi 1998, 341), or the shift of the tax base from high tax to low tax jurisdictions (Palan & Abbott 1996, 182);
- ‘tax competition’, or the attempts on the part of governments to counter tax base migration by offering lower rates or an otherwise more attractive tax climate (Palan & Abbott 1996, 181; Picciotto 1999; Tanzi 1998)
- a resulting reduction in tax revenue, for many individual states as well as overall, i.e. the exhaustion of “the commons which is the world tax base”(Tanzi 1998, 341);
- a change in the structure of the tax systems of most countries, characterized by a shift from corporate taxes to consumer based taxes (Drache 1996, 48) or from capital to labor (Scharpf 1997, 25), a shift from direct to indirect taxation (Palan & Abbott 1996, 181), a shift of the tax burden away from mobile actors and the owners of mobile capital (Scharpf 1997, 18), a shift to a generally more regressive tax regime (Scholte 2000, 240); in the words of Susan Strange, “the national tax burden falls increasingly on the individual citizen, and to a growing extent, through the spread of value-added forms of indirect taxation, on small local businesses.” (Strange 1996, 63).

It is remarkable that these claims go almost completely unsubstantiated: no matter how intuitively plausible they may be, it would be nice if we could show that these effects actually occur. But in most cases, unfortunately, the evidence is sketchy, anecdotal and contingent.

Some recent publications have tried to shed light on the questions raised here. Fritz Scharpf, in a largely qualitative argument, analyses the occurrence of tax competition and its a-symmetric consequences for various actors involved (Scharpf 1997). He concludes that “the

internationalization of the economy and the systemic competition between states [is] *ceteris paribus* favorable to mobile actors and the owners of mobile factors of production, while it limits the capacity to act on the part of states” (Scharpf 1997, 18; my translation, HO). Scharpf observes that in the OECD area the share of taxes on wages in the total tax take increases over the years 1965-1994, as does the share of social security contributions. “The tendency towards a shift of the financing burden to wage income that is hardly internationally mobile is therefore very outspoken” (Scharpf 1997, 25; my translation, HO). Furthermore, Scharpf also sees a shift of the taxation burden from financial to productive capital. Finally, although generally supportive of what we may call the ‘globalization thesis’, Scharpf recognizes continuing strong national differences, which are primarily explained by the fact that the competitive pressures emanating from globalization are mediated by (historically and institutionally varying) national conditions.

Geoffrey Garrett undertook a more empirically based analysis looking at the same question. Garrett’s overall conclusion is critical of the globalization thesis: he maintains that globalization imposes fewer constraints than commonly thought (Garrett 2000, 108; this is also the position of Kudrle 1999). This conclusion is based on the observation that cross-national convergence does not occur. The only expectation derived from the globalization thesis that is borne out by the facts (but heavily mediated by domestic politics) is the fact that financial openness correlates with decreases in effective rates of corporate taxation. Garrett then turns to an explanation for the fact that overall capital taxes seem not to have been reduced by capital mobility. One answer often quoted in the literature is that there are long-term negative effects of capital flight for countries with high tax rates. The evidence for this is weak: differences in institutional strength seem to compensate adequately for higher tax rates. The alternative explanation, preferred by Garrett, is that changes in capital tax have been more or less consistent with the interests of mobile investors and multinational firms. “Methods of taxation [are] more consonant with business preferences” (Garrett 2000, 134). Unfortunately, Garrett has not attempted to analyze in detail whether these interests and preferences actually existed, and how they were expressed in the political arena.

Finally, Steffen Ganghof has presented the most thorough analysis of the impact of competitive pressures on tax policy in the OECD countries (Ganghof 1999). He begins with the observation

that tax differentials have a small impact on manufacturing businesses, but a much greater impact on financial and commercial companies. In the case of personal income, likewise, the impact on labor income (excluding highly skilled labor) is much weaker than on income from financial assets. There are four strategies that states may mobilize to counteract decreasing tax revenues as a consequence of increased fiscal competition. The first option would be to *cut general effective tax rates*. The data do not show any strong downward trend in tax rates, however; there is even a considerable rise of the tax burden on the lower end of the earnings scale (which Ganghof attributes not to competition, but to a change in the philosophy underlying tax policy). The second option for states is to *cut statutory tax rates* (which have an important signaling function as well as in some cases affecting the (re-) location of income). Here, the data show a clear downward trend that Ganghof again ascribes primarily to the shift in philosophy rather than to really existing tax competition. Third, states can introduce *differential tax cuts*. In the area of corporate taxation, so-called preferential tax regimes (e.g. favoring foreign investors over domestic investors) are increasingly important. In the area of personal income, two roads are followed here. One is to remove specific forms of income from the general imposition of income tax (this is often done with income from financial assets). The second, more radical, option is to introduce what is known as dual income tax, that is separate tax regimes for income earned from labor and (at lower rates) income earned from capital (as some Scandinavian countries have done). Finally, states can take *legal and administrative counteraction* (e.g. combating the use of tax havens etc.). In addition to action taken by states, there are also certain countervailing pressures operating in the global economy, which keep tax competition under control. The most important of these is that to transfer the tax burden from capital to labor and to immobile assets itself has negative competitive repercussions because it tends to broaden the tax wedge (between gross and net take-home pay) and drives up property prices. Ganghof concludes, and here he is in broad agreement with Garrett and Scharpf, that we see a “medium-term stability of average budgetary outcomes” (Ganghof 1999, 46), which means states seem capable of maintaining their revenues notwithstanding increased competitive pressures arising from globalization. Three factors are responsible: the institutional framework of international taxation and non-tax factors; the successful combination of tax cuts – cum – base broadening, differentiation, and legal and administrative counteraction strategies; and the operation of domestic (electoral) and international (competitive) countervailing pressures. In sum, states have not lost revenue, but

have changed the structure of their taxation systems into a more controversial (= inegalitarian) direction.

Which of these expectations can be confirmed from a first analysis of available OECD data on taxation? We have brought together the most central data on the development of taxation in the OECD area in Table One. Both the studies quoted above and the summary data in the table give rise to similar conclusions and observations.

First, contrary to expectations, states so far do not seem to experience serious difficulty maintaining their overall revenue base. The overall share of taxation in GDP rises throughout the EU, from an average 28.7% in 1965 to 41.2% in 2001. Given the shift to neo-liberalism this may be remarkable, but it might be explained by the boom conditions dominating much of the 1990s.

Second, corporate taxation produces between 6 and 8 % of total taxes throughout the whole period under consideration (and increases rather than declines). This seems to belie the suggestion that under neo-liberalism there is a shift from corporate to personal taxation. However, it cannot be ascertained from the data analysed here what proportion of personal income is income from labour and what proportion is income from savings and investments. To get a more accurate picture the meaningful contrast of course would be that between the tax burden on labour income and the tax burden on corporate plus personal investment income. The data would further need to be corrected for changes in the relative shares in GDP for personal and corporate income. It has been suggested by the OECD that since the recession of the early 1980s the share of profits in GDP has risen substantially, so that in effect the taxation rate of corporate income has gone down. There are two approaches to this question. The first would be to calculate the profit share in GDP. If we take as a first rough (and admittedly imperfect) approximation the share of corporate operating surplus in GDP (calculated from OECD National Accounts Statistics), we see that between 1970 and 1996 this ratio varies only slightly between highs of 26.4 % (1970) and 25.2 % (1988) and lows of 22.8 % (1982) and 23.7 % (1992). In 1996 it stood at 25 %. There is thus no clear indication that the profit share in national income is structurally increasing.

Thirdly, personal income. The tax burden on personal income, as the table shows, rises between 1965 and 1980, but stabilises thereafter; social security contributions however rise continuously. Taken together, the tax burden on personal income plus social security contributions rises from 13.5 % of GDP in 1965 to 21.3 % in 1980 and to 22.2 % in 2002. Its share of total tax income rose from 46.3 % to 53.9 %. In addition, indirect taxes on general consumption (VAT) rose rapidly as well. Together this means that the share of taxes on personal income in total taxation rose from some 60.5 % to 72.5 %, while the shares of taxes raised from corporate income, property, and indirect taxes on specific goods and services (e.g. on luxury items) fell from almost 36.3 % to 23.4 %.

These figures clearly demonstrate that while maintaining their revenue base states tend to alter the structure of their tax system significantly. The shift of taxation from capital to labor is quite evident. Where these shifts in taxation take place, ideology as Ganghof points out often seems to be as important an explanatory factor as 'real' competition. The picture that thus emerges from this short survey is that globalization is not an exclusively external pressure operating on states. There is rather a complex and two-way interplay between global processes and pressures, and national historical, institutional, and political variables. In this complex picture, it is necessary to underline that the structural discipline that tax competition imposes on governments goes way beyond the epiphenomenal question of whether or not governments have actually seen their revenues drop.

Table 1. Tax revenue as percentage of GDP, EU-15, 1965-2002

	1 9 6 5		1 9 8 0		2 0 0 2	
	% of GDP	% of tax total	% of GDP	% of tax total	% of GDP	% of tax total
1) Total*	28.7**	100.0	36.0	100.0	41.2 ***	100.0
2) 1000 tax on income & profits	8.8	30.4	12.6	33.6	14.0	34.1
- 1100 of which tax on personal income	7.2	23.5	11.0	28.8	10.8	25.8
- 1200 of which tax on corporate income	1.9	6.7	2.1	5.8	3.4	8.6
3) 2000 social security contributions	6.3	22.8	10.3	29.2	11.4	28.1
4) 3000 taxes on payroll and workforce	0.4	1.4	0.5	1.5	0.5	1.0
5) 4000 taxes on property	1.8	6.7	1.5	4.2	1.9	4.9
6) 5000 taxes on goods and services	10.4	38.2	11.0	31.1	12.3	30.8
- 5100 of which consumption taxes	9.9	36.2	10.5	29.8	11.5	28.4
- - 5110 - of which general consumption	4.1	14.2	5.9	16.0	7.5	18.6
- - 5120 - of which tax on specific goods and services	6.0	22.9	4.7	13.8	4.0	9.9

* = 3-year moving average; ** = 1966; *** = 2001

Source: OECD (2004), *Revenue Statistics 1965-2003* (Paris: OECD).

5. Conclusions

This paper gives rise to a number of conclusions and considerations. Lack of time forces me to indicate these only very briefly here and leave the further elaboration for a later date.

First, it is clear that the issue of corporate taxation has gradually floated to the top of the agenda in the EU. There are several factors contributing to this.

The first way of looking at it would be to point out *the path dependency* of the whole process. The adoption of the SEA and the project to complete the Internal Market have set in motion an inescapable logic of removing all obstacles in the way of free capital mobility across borders, forcing governments, sometimes grudgingly, to accept the unintended consequences of their actions. While such an institutionalist argument may certainly help to clarify the precise trajectory of the process, it cannot help us to understand why the process was set in motion in the first place, nor why the balance of forces between the various sides in the ongoing struggle is configured in the way that it is.

Second, the role of two key EU institutions (the Commission and the ECJ) in promoting the case of some form of harmonization of EU corporate taxation is remarkable, as well as is the convergence in views between these supranational institutions and transnational business represented by the ERT. This might be seen as vindication of the tenets of supranational institutionalism (see Sandholtz & Stone Sweet 1998; Sandholtz & Zysman 1989). However, the weakness of this approach is that it remains rather under-theorised. Thus, for example, there is no explanation of where transnational interests come from and why they would be so powerful. There is also no explanation of the *content* of the converging views of European institutions and transnational business, the *social purpose* of their project so to speak. In sum, although supranationalism does open the black box of the national state (indeed, in this tradition the state never was a black box) by emphasising the role of (transnational) social forces, there is no conception of how these social forces may shape the socio-economic content rather than only contribute to an ever more supranational form of the integration process.

The analysis of the development of the structure of taxation in the EU over the past decades showed that tax competition between the member state has not led to the result predicted by so many authors, namely that total tax revenue would suffer. Not even has the share of corporate taxation as a percentage of GDP consistently declined. The broadening of the tax base by governments has enabled them to stabilise their revenues. However, the analysis did confirm that the share of taxes on personal income in total taxation rose by more than a fifth over the period, while the shares of taxes raised from corporate income, property, and indirect taxes on specific goods and services (e.g. on luxury items) fell by a third. Together these movements confirm the picture that Scharpf painted rather intuitively: taxation is gradually shifting from mobile to geographically fixed income sources, and from high income to low income brackets. The neo-liberal social purpose of the restructuring of taxation in the Single Market is thus clearly revealed, thus corroborating the theoretical approach briefly sketched in the second section of this paper.

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