EUROPEANIZATION AND TAX POLICY

By László Csaba

It would be difficult to find an issue area which is more topical and controversial, especially following the eastward enlargement of the European Union, than tax policy in the context of Europeanization. In the following pages I shall formulate a couple of critical remarks that may help to move ahead with the exchanges. As most of the observations of Frank Bönker are either valid or deserve further reflection, the discussant must confine his comments, due to limitations of time and space, to spelling out the major points of disagreement to stimulate debate.

First and foremost, the major finding of the paper, highlighting what the author terms as de-Europeanization is a valid and novel insight. It goes without saying, especially since the rejection of the Constitutional Treaty by the French and Dutch electorate, and increasingly by the British and Polish political class, that the Panglossian view of much of the European studies literature is in need of a thorough re-assessment. The meagre compromise of the Brussels Council of June 2007 over „re-launching” a Basic Treaty only underscores this point. The author is also right in highlighting the less than enthusiastic pro-EU approach of the new member-states, and let us add, not only and not even primarily in our area of investigation, i.e. tax policies. Similar approaches can be observed in agricultural policies, where the long overdue reforms of backward-looking arrangements are being blocked by the new member-states. The debate over further enlargements, again, is lamed, not only by the fears of the old members, such as France, where any further enlargement after Croatia will be subject to referendum. But also among the new member states the overall feeling is that EU must first be consolidated, and only later enlarged. In other words, they act as anything but forefighters for future enlargements, or guardians of interests of those lagging behind, from the western Balkans to the Ukraine.

Under this angle it is both topical and relevant for us to reassess the meaning and mechanism of Europeanization. It holds, perhaps not only with the benefit of hindight, that Europeanization can not and should not be conceptualized as a unilateral, top-down process in which external pressure plays a pre-eminent role and the copying of pre-existing institutions and policies dominate the overall process. This approach, though obviously present in the literature, seems to have arrived at hasty and premature generalizations based on the peculiarities of one period, namely of acquis screening. Then the entry in the EU has indeed required cross-checking the practices of the then candidate countries, with a low level of credibility and limited amounts of track records over a rather short period of time characterized by swift changes. The lasting or temporary nature of the latter had been a subject of debate, thus the unusually intrusive controlling practices of the Commission as a policy entrepreneur ensued.

However it would be wrong to overlook the findings of the broader literature/Thatcher, 2003, Grotz, 2006/, especially on the old member-states, that has shown

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1 Professor of Economics and European Studies, Central European University/Budapest and Member/Corr./ of the Hungarian Academy of Sciences.
2 Hungary does not support any change of the current arrangements, as explicitly formulated in a recent interview given by the Minister of Foreign Affairs in: *Figyelő*, vol.51.no.15/2007/.
Europeanization to be an iterative process of *mutual* adjustment. While the relevance of the Community level policies and institutions has never been questioned, the interaction of these with national policy entrepreneurs has been a complex one, with the initiative often coming from the domestic players/Wagener-Eger-Fritz,2006/. In this approach there is nothing surprising that states that have newly regained their sovereignty do make use of the leeways in standard policy practice of shaping Community practices.

This holds all the more so for tax policies, an area where the transfer of competences to the Community level has been limited and fragmentary. Recurring attempts by the high tax countries, such as Germany and France, as well as the Commission to create tax authority, especially with policing powers over tax evaders, has long been resisted by the countries profiting from the status quo such as Luxemburg – and also by those who disagree with the very idea of tax harmonization on grounds of economic principles, such as the UK or Austria. Timid attempts of the Commission to introduce uniform base for calculating corporate taxes has already encountered resistance and led to postponement of such ideas by several years.

From a *normative* perspective it remains to be established if and under what conditions Community level *centralization of taxing powers and procedures* would benefit the common good/other than the convenience of fiscal authorities in the high tax countries/. High tax countries do not show an economic performance that would allow them to posture as champions of the Lisbon Strategy. For instance German economic growth decelerated from 2.0 pc in 1996-2000 to 0.6 pc in 2001-2005, and even the 2006 good year of 2.7 per cent was still below the average of the EU of 3 pc. French economic growth also decelerated from 2.7 to 1.5 per cent, and the 2006 performance of 1.7 pc is also unimpressive. Finally for Italy the respective figures are 1.9 and 0.6 per cent, with 2006 closing with 1.9 per cent/all data from: ECB *Statistics Pocket Book*,March 2007.Frankfurt/M,p.37/. The performance of Hungary in the same period showed 4.3 and 4.o, in 2006 3.9 pc, Estonia 6.1 and 8.3, in 2006 11.5 pc, and the examples all go in the same direction. In short, the call for „level playing fields” seems to be widespread rather than soundly substantiated.

The case becomes even more complex if analysis, as so often, focuses on corporate tax rates only. It is anything but trivial that any single item of a complex and intransparent system of public dues is indeed in a position to carry a meaningful message on the competitive position of any locality, whatever way we interpret this concept/more on that in Siebert,2006/. It can be proven in detail, both via theories and empirical evidence, that capital in general does not flow from rich to poor countries, and in particular, it does not flow from high tax to low tax localities, especially not in the past 25 years, and especially good quality FDI does not follow this pattern/Csaba,2007/. A sheer look at the competitiveness and economic freedom indices of various international agencies would indicate that it is typically the high tax countries as those in Scandinavia, or such highly regulated economies as Singapore, that are found to be the most lucrative localities.The reason for this is clear. Investors care about the *balance* of costs and benefits, and in a transparent environment they are more than willing to pay for the rule of law, enforcement, good

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1 Good quality FDI is what contributes to continuous upgrading of the locality it flows to, allows for the Hirschmanian forward and backward linkages, as contrast to FDI that focuses exclusively on the appropriation of non-renewable natural resources, without caring much about future consequences.
quality environment and well trained and cooperative local labor. In short, there is no quick fix.

What explains then the drive towards lowering corporate taxes in the new EU members, as documented in the literature? The answer is relatively straightforward. First, in the era of unrestricted capital mobility regulators must pay attention to the needs of the most mobile factor of production/since it is not only FDI which matters, but portfolio investments matter even more/. Second, localities must send certain signals to investors about their changed, more forthcoming attitudes. Lowering the corporate tax might be such a quite visible, still not very expensive signal. Finally if the regulatory environment is intransparent, and policy practices tend to be inferior to written legislation, there is a need to sweeten the bitter pill for those who decide to stay. The above mentioned circumstances have been featuring in most transition economies, especially prior to EU accession.

And herewith we arrive to the idea of tax revolutions as exemplified by the introduction of the flat tax. At one level of abstraction the flat tax has long been a pet project of supply siders, since it allows, without the usual compromises, the implementation of basic insights of microeconomics. These include simplicity, transparency, equity, low administrative costs, high probability of compliance and a number of others. On the other hand practical people/such as tax consultants/ but also students of policy experience, may wonder why none of the established democracies, and not only the continental ones, have not resorted to this practice?

One conceivable answer lays in the symbolic and political components of taxation. Who pays what and how has always ben one of the issues which are intrinsically political in any society. For this reason established democracies tend to apply complex systems embodying a variety of compromises. By contrast, systemic change has opened up the opportunity for experimentation. The role for constructivist approaches has, for a while, been open. If some governments, like the Estonian or the Slovak or more recently the Romanian, coming out of rather unfavorable historic heritage, decided to send a signal to the outside world, both on their overall policy agenda and also on their changed/favorable stance on FDI as a strategy, the low flat tax has become an option.

It is important to recall, that empirical observation of the flat tax in both Russia and Slovakia have indicated, that in terms of actually inflowing public dues, the increase of the lower rates/such as on foodstuffs/ has, at the macrolevel, implied a tax increase. In the case of Russia non-payment of public dues was rampant in the pre-Putin era. Thus the introduction of the 13 pc flat rate, that indeed was being collected, since 2001 also implied a de facto tax increase. For these reasons the benefit of favorable foreign publicity could be combined with the benefit of additional fiscal intakes.

Under this angle the consideration of European unification has not been particularly powerful. Given the limited competences and controversial legal status of the EU tax regime, it did not seem particularly daring to experiment here rather than in other issue areas. The economic/tax policy chapters in accession have long been closed, and it seemed unlikely that the core EU would ever sacrifice its Big Bang strategy,

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4 For these reasons very few of the contemporary economics departments would condone progressive taxation to qualify as `the pride of democracy` these days.
motivated inter alia by the Balkan wars, for something which has internally long been disputed anyway. Thus the opportunity as well as the incentive to act has been given. By contrast, the drift of the 2002-2007 period, that has led to postponement of joining the single currency, does not seem to have been a conscious policy option of the new members. Among the local sources of professional economic discourse one rarely finds, if at all, arguments cited by the authors, that would positively advocate giving up the prospect of euro-zone membership. It is just the target date which has been moving from the original 2006 first to 2008, then 2010 and more recently for 2015.

In conclusion two observations may be due. First, discontinuing the overcompliance of the early transition period should not qualify, in theory or even in policy terms, as de-Europeanization, since the latter term does not have to mean more standardization. The open method of coordination, or the practices in the environmental acquis do not point in this direction. Second, Europeanization, as an interchange between the local and the EU level, is alive and well. Legislation, also items directly enforceable via the European Court of Justice, have been pouring ever since the rejection of the Constitutional Treaty. Interactions among firms, regions, citizens, i.e. integration at the micro and meso-level is alive and well. Also on the macrolevel, compliance with the stipulations of the Stability and Growth Pact is on the increase, and some of the Lisbon Agenda, such as increasing labor market activity and decreasing unemployment rates is also being implemented.

In short, enlargement has enhanced the discourse over slowdown of the European train. It has not, in reality, translated to the actual laming of the vehicle. In line with its history European integration proceeds, from crisis to crisis, on its road to irreversible deepening. Living with growing diversity, also in the area of tax policy, is perhaps a precondition for this broader aim to materialize, now and in the foreseeable future. The fact that e.g. competition agencies start to be more effective than before/more on that in Bara,2006/, or that social legislation is being better enforced, seems to contradict to the idea of Europeanization being particularly shallow in new Europe, or at least shallower than in the old members.

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6 Medical doctors in Hungary have won a case, obliging the municipalities to pay the full sum of their dues for overtime work, by involving the EU judiciary in 2006.
REFERENCES


