

# The Euro Crisis: Implications for the Internal Market and Harmonisation of Corporate Taxes

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## Introduction

The so-called 'euro crisis' is of the utmost economic, financial and political importance for all member countries of the euro area and for the future of the Economic and Monetary Union (EMU). In my view, however, it is not primarily a euro crisis in the strict sense. The euro *itself* is of course involved, but, as a currency with a rather stable exchange rate vis-à-vis other currencies and with a major role in global financial markets, it is not at the heart of the crisis. Rather the crisis is a matter of the serious imbalances in the economies of several euro-area countries, particularly their budget deficits and sovereign debts and as well as their lack of competitiveness and balance-of-payments deficits.

This euro crisis has serious implications for the functioning of the entire European Union as well. The essence of the process of economic integration of the 27 EU member states lies in the internal market: one large and internally open market of goods, services, people and capital. The major advantages of the internal market can be further enhanced by the successful functioning of a single currency, initially in the euro area of the 17 and, hopefully, later in the entire EU of the 27.

Numerous financial and economic policies and policy instruments are now involved in a concerted effort to get the euro crisis under

control. Corporate taxation, however, is *not* a central element in these efforts. It is true that two large countries - Germany and France - have tried to create a link between the efforts to solve the crisis and the efforts to bring about some form of harmonisation of national corporate tax policies. But so far, their political manoeuvring has failed. For example, the proposal to introduce the common consolidated corporate tax base (CCCTB) in corporate taxation (discussed below) is *not* intended to serve the EMU and the euro area as a policy instrument but rather, aims at improving the functioning of the internal market of the entire EU.

Action in the area of corporate taxation is *primarily* focused on the functioning of the EU, that is, the internal market of all 27 member states, and not just the euro area of the 17. In other words, proposals for some form of harmonisation of elements of corporate taxation are of great relevance to *all* 27 EU members, including non-euro countries such as Poland.

It is true that corporate taxation as such is not unrelated to developments in the euro area. This relationship is based on the fact that all elements of tax policy form part of the overall government revenues and the general fiscal-budgetary policy of a member country.

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The recent agreement among euro-area members to accept much stricter discipline of national budgets is of crucial significance to resolve the euro crisis. Member countries that are committed to reducing their excessive government deficits may consider taking measures in the area of corporate taxation by raising tax rates to increase overall government revenues. Such action may make sense, in particular, if the country's corporate tax rates are substantially below the European average. (I refer to the case of Ireland, discussed below.)

In a broader context of taxation, this point comes to the forefront in the conditions formulated by 'Brussels' (and the IMF!) in the financial support packages destined for ailing Greece. Greece was – rightly in my view – requested to raise its unsustainably low overall tax revenues to reduce its unsustainably high budget deficit. These tax revenues include corporate taxes. What is typical in the Greek case, however, is that the emphasis is not, as in Ireland, on the tax rate being considered too low but on the *collection* in Greece of any kind of taxes. Its tax collection is unacceptably deficient and should be significantly improved.

One should be aware, however, that national action on corporate taxation in the context of the euro crisis is not part of a European policy initiative towards any kind of tax *harmonisation* with the goal to improve the functioning of the internal market of the 27 member states.

### National differences in corporate tax rates

Both inside Europe and globally, national regimes of corporate taxation show substantial differences. In the past, these differences could hardly be considered a surprise. In recent decades, however, with growing liberalisation of international trade and investment and the increasing globalisation of economic and financial activities, one would have expected more progress towards harmonisation, or at least approximation, in the area of corporate taxation. The differences present themselves in the national statutory corporate tax rates, in the corporate tax bases as well as in the effective tax rates.

Perhaps one would expect that countries with high statutory tax rates would also impose high effective tax rates on corporations. In practice,

this is indeed the case in several countries. However, in other countries, a much narrower tax base – a result of tax exemptions, tax subsidies, lavish deductibles such as depreciation allowances, etc. – offsets a higher rate and produces an approximately equal effective rate.

Examples are manifold. The United States continues to charge a high statutory rate of 35% but offers a relatively low tax base, thanks to legislated exemptions or concessions yielded to active members of Congress or effective lobbyists. The net result is mixed, with an effective US rate that is relatively attractive for some US-based companies and relatively unattractive for others. Germany used to be a less competitive country from a corporate tax point of view, with high rates and a rather average tax base. During the last two decades, however, it has lowered its statutory rate and has probably become closer to the average as far as the effective rate is concerned. France continues to be on the high side for both the statutory and effective rate. On the other end of the spectrum is Ireland, which has stuck to its extremely low statutory rate of 12.5% – introduced in the 1980s to make its underperforming economy more competitive and attractive. This factor has led to an exceptionally low effective tax rate (at least among the EU members before the enlargement of 2004).

My own country, The Netherlands, is interesting in the sense that it used to apply a relatively high corporate tax rate of 48% with, however, a relatively low tax base and probably a close-to-average effective rate. As Minister of Finance, I pushed through a substantial reduction of the statutory rate in 1988 from 48% to 35% (which was at that time considered very competitive internationally), with a simultaneous reduction in tax subsidies and exemptions for corporations, and consequently an increase in the Dutch tax base. My successors in the Ministry wisely continued this policy and reduced the statutory tax rate to its current level of 25%. This long-term process was accompanied by a combination of a rising tax base and a declining effective tax rate.

I am still today an advocate of the same recipe for developed countries: a lower statutory corporate tax rate and a higher tax base. There are numerous advantages: more transparency, less complexity, lower perception of the cost of tax collection for both the national tax administration

and the tax departments of companies, fewer disputes and tax cases in the courts, less opportunity for tax evasion or fraud and finally, clearer comparison among various different countries of their level of the effective corporate tax burden.

Consequently, I favour the adoption of a harmonised tax base in the EU, through a CCCTB (common consolidated corporate tax base), together with a trend towards a broadening (on average) of the current size of national tax bases combined with a degree of approximation and a further reduction (on average) in the current levels of national statutory tax rates in the EU.

### Harmonisation of the tax rate vs. the tax base

As far as harmonisation of corporate taxation is concerned, not surprisingly, the focus of the political and academic debate in the EU is both on the statutory tax rate and the tax base. This debate received a serious foundation in 1992, with the report of the Committee of Independent Experts on Company Taxation, prepared at the request of the European Commission ('Ruding Committee').

Since then, however, hardly any progress has been achieved, partly because of fundamental differences of views among the member countries and partly because of the requirement of unanimity on tax matters for EU decisions.

Already at the time of the 'Ruding-Committee' report in 1992, I came to the conclusion that, on the one hand, a comprehensive and full harmonisation of the corporate tax in the entire EU was neither necessary for the goal of perfecting the internal market nor politically feasible but, on the other hand, a certain degree of coordination and approximation was needed to eliminate a number of serious differences in national tax legislation and practices in order to remove distorting obstacles to the proper functioning of the internal market. Probably the most unacceptable distortion was – and is – the double taxation of cross-border activities of companies active in several EU countries. Particularly egregious were the cases of companies paying higher corporate tax than competitors active in one country only. This leads

to an uneven playing field and unfair competition within the EU.

Although our remit in 1992 was to study primarily the corporate tax *rates* – and we submitted quite a number of valuable recommendations in this area – we also came to the recommendation that priority should be given to making progress on the highly complex matter of harmonisation of the widely varying national tax *base* in the EU countries.

If and when the EU achieves a sufficient degree of harmonisation of the tax base – and this is still uncertain! – attention can and should shift to the corporate tax rate. This is not assured, however, as one could imagine a political decision towards harmonisation of the tax base without a political agreement to harmonise the tax rate. As far as the end game of this process in the EU is concerned, I would advocate some sort of middle-of-the-road outcome. On the one hand, there should be a reduction in the near full national sovereignty that now prevails in matters of corporate taxation, by replacing unanimity with qualified majority decisions and with a substantial narrowing of the wide differences in national tax rates. On the other hand, however, member states should be granted a certain degree of latitude to allow them to compete on the basis of the level of their corporate tax rate; or, in other words, to retain a moderate degree of national sovereignty in this domain.

I continue to consider it difficult to reconcile a well-functioning internal market in the EU with exceptionally wide differences in the corporate tax rates. I am referring to Ireland's decades-long rate of 12.5% and to even lower rates in several of the new member states in Central and Eastern Europe that joined in 2004. Such large differences may create serious distortions in competitiveness among companies and, therefore, in the functioning of the internal market.

This may result in an EU framework along the lines of the 'band proposal' that was adopted for indirect taxes, in particular the VAT, during the 1980s: a minimum rate and a maximum corporate tax rate, with a moderate although not insignificant width in-between for national freedom of manoeuvre and tax competition.

Such an idea was hinted at in the Ruding report of 1992. Later, it was misinterpreted as a bias

towards relatively high corporate tax rates, along the preferences of high-rate countries such as Germany and France, with statutory rates at or above 40%. They indeed were trying to push upward the rates of other European countries with relatively low rates (30-35%), such as The Netherlands. My preference at the time was, however, different: not a push upwards but rather, approximation of the national statutory rates not far from the then prevailing EU average. In 1992, this would have implied a range between 30-35% or perhaps between 30-40%. Today these numbers are different. In recent decades, several autonomous decisions by sovereign EU member states to reduce their national corporate tax rates changed the spectre of 'old' members; and the entrance of the 'new' members in 2004 added several countries with extremely low statutory rates (although not necessarily always the lowest effective corporate rates). So, if one would indicate an appropriate band today for corporate tax rates in the EU, one could think of 20-25%, or somewhat wider on both sides. This would assume, however, that several countries would combine lowering their tax rate with widening their tax base.

Two final remarks on matters of rates. In many debates about the optimal policies for corporate taxation in Europe, the positions were presented as a black-and-white contradiction: one favours tax harmonisation in the EU or one favours tax competition between the member states. As I have outlined above, I do not see this as an either/or case. We should agree on a compromise outcome, with more harmonisation than today while retaining sufficient room for competition in the national rates.

My second point is related to tax transparency. EU harmonisation of the corporate tax base will undoubtedly make it easier as well as more relevant to judge the relative attractiveness, or lack thereof, of the level of the statutory tax rate of a particular country. Nowadays, a lower statutory rate in A than in B does not always imply a lower effective rate in A than in B. After harmonisation of the tax base, it will be easier to determine that country X, with a lower corporate rate, is more attractive and more competitive, from a corporate tax-burden point of view, than country Y. This greater transparency may put pressure on Y to reduce its relatively high

statutory rate in order to attract foreign investment. This argument of tax competition is welcomed by those who favour lower statutory corporate rates but is opposed by others who prefer to keep the prevailing higher rates.

## France and Germany

As mentioned earlier, it is interesting to observe the political positions of France and Germany on this subject. These two countries have been constantly trying to achieve a degree of harmonisation of the corporate tax rate in the EU; particularly to accommodate their own interests. Traditionally they charged relatively high rates compared to most other EU countries. They advocated a sort of approximation, possibly by way of an agreement towards a 'band' (as explained above), with a maximum and a minimum rate to be observed by all EU countries. My problem with the French-German approach was that they advocated - in the early 1990s - an excessively high level for the minimum rate, that is, close to their own national rates which at that time were close to 40% and higher than most other members. Nothing has come out of that initiative.

However, in 2010, in the midst of the sovereign debt crisis in the euro area, France and Germany re-launched their old idea. They tried to make use of the conditions to be imposed on the three countries - Greece, Portugal and Ireland - applying for financial support from other euro countries, by urging Ireland to accept a substantial increase in its very low (12.5%) rate. Ireland flatly refused such a condition. This proposal was not very convincing in the context of the Irish debt and deficit problem.

Unlike Greece and Portugal, the root problem in Ireland is caused by, first, the outrageously irresponsible behaviour of the construction and real estate sectors of its economy and the eagerness of all Irish banks to indulge in a lending orgy to these sectors and, second, the decision by the Irish authorities to provide an unlimited government guarantee to all creditors of all banks in Ireland. This latter decision has ruined the Irish government's finances, but the unsustainable budget situation was *not* primarily caused by the more traditional factors such as overspending and/or insufficient government (tax) revenues, like in Greece.

Also, whereas France today still applies one of the highest corporate tax rates in the EU, Germany has made downward moves since the 1990s and is no longer in the same high-rate category as France. In 2011, these two countries, and particularly France, tried to renew their approximation proposal in the context of the general efforts to increase economic and fiscal coordination and common 'governance' in the euro area. This subject therefore deserves full attention in Central and East European member countries with low corporate tax rates, irrespective of whether they are inside the euro area or outside.

Some observers had expected that France and Germany would try to include a reference in the Treaty on Stability, Coordination and Governance in the EMU (the so-called 'Fiscal Compact'), as approved at the European summit of 31 January 2012, to an obligation on the part of deficit members in the euro area towards coordination of the corporate tax (that is, an increase in their corporate tax rate). In fact, however, the Treaty makes no specific reference to corporate taxation.

### Harmonisation of the tax base

From the 1980s until today, the EU has made hardly any progress towards the harmonisation of the corporation tax, despite the recommendations in the Ruding report and several proposals submitted by the European Commission. After 2000, the Commission decided to concentrate its efforts on the tax base and to leave action on the tax rate for later. The Commissioners in charge of tax policies, first Mario Monti and then Frits Bolkestein, proposed several versions of harmonisation of the tax base by means of a Common Consolidated Corporate Tax Base.

The most ambitious approach was to reach agreement on a Directive with a mandatory harmonisation through a CCCTB that would be binding on all companies active in one or more of the 27 member states. Subsequently, after this proved to be politically unacceptable to a number of countries, a 'voluntary' approach was launched, based on an optional system in which each company (better: group of companies) would decide whether it will – or will not – apply the rules of the CCCTB to all its activities in the EU.

The alternative fallback position is the proposal to circumvent the requirement of unanimity and the recalcitrance of several countries, such as the UK and Ireland, by means of a limited number of members reaching an agreement to introduce, in a binding manner, CCCTB in this group of countries only. The Treaty of Lisbon explicitly permits such 'enhanced cooperation' provided a minimum of one-third (9 out of 27) of the members participate. This would lead to another case of a two-speed Europe, in a specific policy area. As in the case e.g. of the Schengen agreement, the justification lies in the preference for (geographically) limited progress towards integration above no progress at all, combined with the hope, or expectation, that other members will later join this initiative.

After a period of passivity under European Commissioner László Kovács (in charge of tax policies), the current Commissioner Algirdas Šemeta re-launched the debate in 2011 with a new draft Directive to introduce a CCCTB with the (above-mentioned) optional character. As may be expected, this proposal will not achieve the required unanimity in the EU. Then the European Commission and/or several supporting member states are expected to propose the (above-mentioned) enhanced cooperation version for a more limited number of members. So, this is still work in (slow) progress in the EU.



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