The spectre of tax harmonisation

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Philip Morris is Europe's leading tobacco manufacturer. As a major collector of taxes—in the European Union alone consumers pay over €20 billion in excise duties and VAT on Philip Morris products to governments per annum—we are very interested in European tax policy and encourage public discussion on important policy questions such as the harmonisation of taxes. We are therefore delighted to sponsor this thought-provoking pamphlet by Kitty Ussher of the Centre for European Reform.

Tax harmonisation is not an end in itself. The Treaty of Rome asserts that the harmonisation of indirect taxes is only necessary to fulfill the smooth functioning of the Single Market. In an area we know well—tobacco taxation—this has led to a harmonised 'tax framework' but not full harmonisation of tax rates. Ultimately, harmonisation may result from the gradual convergence of European economies. Meanwhile, subsidiarity, flexibility and a degree of pragmatism will continue to be important in determining European tax policy. Without it, the policy cannot take into account the diversity of economic characteristics and of the political, social and fiscal objectives of the 15 member-states.

1 Setting the scene, dispelling the myths

Europe's citizens, generally speaking, do not want their taxes set by Brussels. Taxation and representation still go hand in hand. So it is safe to assume that so long as people continue to look to their national governments to represent their interests (and turn out to vote for their national politicians in greater numbers than for MEPs), they will reject the notion of taxation policies being decided at European Union level.

Before the launch of the euro the tax harmonisation issue was of peripheral interest, seemingly confined to discussions of the single market. The establishment in 1977 of a common system of indirect taxation was no more than a sensible correction of the market distortion produced by having different tax rates on tradable goods. With the launch of the single European currency in January 1999, however, the debate has sharpened. Surely, many commentators speculated, a common monetary policy across a number of countries would require a common fiscal policy, too? And once levels of spending were co-ordinated, would it not be only a matter of time before the ability to raise taxes was, as well? Others skipped the rigour of economic logic, raising instead the spectre of the slippery slope: once one aspect of economic policy is handed over to central control, others must surely follow. Suddenly the tax debate was no longer about boosting the single market but whether the whole single-currency project required national governments to relinquish their age-old right to raise taxation.

This angst has been particularly deep in Britain, which has warily watched from the sidelines the introduction of the single European currency, unsure whether to join. In late 1998 a large section of the British popular press gleefully ran stories implying that a single European currency would inevitably usher in a single European rate of tax. It did not take long for the British public to conclude that joining the euro would mean tax rises, particularly as income-tax rates in Germany are ostensibly higher than in the UK. British support for membership of economic and monetary union (EMU) dipped as a result. But are these fears grounded in fact?

The immediate answer is no. Even if there were an economic logic for tax harmonisation, any European initiative on taxation policy could become law only with the unanimous approval of all EU member-states. It is therefore impossible that Britain, or any other EU nation, could find its taxes put up, or altered in any way, against its will. And since the present need for unanimity may itself only be altered by a unanimous vote during a revision of the EU treaties, the status quo is highly likely to prevail. Quite simply, if Britain doesn't want tax harmonisation, it won't happen.

Neither does the euro of itself require a harmonised tax regime. Countries within the euro-zone are bound only by two constraints. First, they must keep their overall budget deficits to within three per cent of gross domestic product (GDP, a country's economic wealth)—and in a severe recession this constraint is relaxed. Second, overall levels of government debt should be below, or declining towards, 60 per cent of GDP. Within these broad limits, how taxes are raised and spent is immaterial.

A common error is to confuse net levels of government spending with the overall size of state revenue and expenditure. To be part of the euro-zone requires governments to keep net levels of spending within limits. But it does not matter whether a government pursues high-tax, high-spend policies or seeks to prune back the role of the state. As long as the amount of money spent is not much more than the amount of money raised, the euro-zone rules of the game will have been met. To illustrate this point, look at how the size of the state in the national economy varies between European countries (see Table 1 on next page). In France, for example, government spending accounts for around half of gross domestic product, whereas in Ireland it is one-third. The two governments need very different levels of tax revenues in order to balance their books, yet both have adopted the euro.

The origin of the scare stories in Britain came from comments made in November 1998 by the leftist finance minister of Germany, Oskar Lafontaine, who saw fiscal harmonisation across Europe as a preferable alternative to unpopular supply-side reforms at home. On the fringe of a meeting of EU finance ministers Mr Lafontaine said that tax

TABLE 1: THE VARYING SIZE OF STATE SPENDING IN THE EURO-ZONE
PERCENTAGE OF GDP (1998)

Austria	49.4
Belgium	51.0
Finland	49.1
France	54.3
Germany	46.9
Italy	49.1
Ireland	33.1
Portugal	43.6
Spain	41.8

SOURCE: OECD *WORLD ECONOMIC OUTLOOK*

harmonisation would be a priority of the forthcoming German presidency of the EU. A few days later he said that EU governments should be prepared to abolish the rule of unanimity in voting on taxation. His comments found a natural home among those sections of the British press that were keen to push anti-European stories. Mr Lafontaine was subsequently discredited by his abrupt departure from the German cabinet. But the question he raised should nonetheless be addressed. Is the spectre of tax harmonisation haunting Europe? Indeed, should we harmonise EU taxes?

This pamphlet examines the various arguments that have been put forward in favour of harmonising EU taxes. The word 'harmonisation' is used loosely to mean simply a deliberate convergence of tax regimes, including rates of taxation. Most of the arguments do not stand up to scrutiny. Even where a theoretical case can be demonstrated, such as to prevent tax evasion and boost the single market, real-world political constraints are likely to undermine the scope for further harmonisation.

These two factors—a slim theoretical basis plus *realpolitik*—have reduced the EU's current discussions of tax harmonisation to a much more mundane set of issues than the eurosceptics had feared. There is a Commission proposal on the table, part of a package put forward by Mario Monti, the former EU Commissioner for the single market, which seeks to prevent individuals who hold savings abroad from evading tax by introducing a common 'withholding tax'; but this is contentious and may not be agreed.

The Monti package also includes a popular measure to abolish tax on cross-border payments of interest and royalties between associated companies (those with subsidiaries or formal partners). As another part of the package, EU ministers are trying to identify and eliminate instances where tax policy is used to grant unfair exemptions to certain companies and industries. A proposal to extend the scope of EU-wide energy taxes has run into political difficulties. The Commission also plans to publish a report on the extent to which tax exemptions allow companies to deviate in practice from the headline rate of corporation tax. And that is all. While the Commission has the authority to push for convergence in levels of value-added tax (VAT), its attempts to do so have been stalled by huge political obstacles. There are no plans to harmonise rates of income tax or company tax.

The conclusion that emerges from this pamphlet is that the European Commission—and indeed national politicians and officials—should concentrate not on tax rates, but rather on harmonising tax *bases* throughout the EU. The Commission should devote its energies to eliminating tax exemptions in different member-states, enforcing EU competition policy more strongly and developing a common accounting standard for EU companies.

For while there may be no direct link between the euro and tax policy now, in the longer term the two are connected. The adoption of a single currency will increase competitive pressure in the single market, tending to erode over time the differences in rates of taxation. This is a good thing as it will draw attention to the underlying competitiveness of countries. But the process will be undermined if different countries maintain different tax bases—as a result of multiple tax exemptions, weakly-enforced competition policy or variable accounting standards—and thus prevent the economic gains of the single market from being fully realised. It will take years of meticulous effort to harmonise tax bases, but that is what the technocrats are there for. And once all countries operate a common tax base, the market will determine how far tax rates need to converge.

Before this conclusion is fleshed out, however, it is as well to tackle some of the myths and misinformation that dog the UK debate on tax harmonisation. The biggest culprits are newspaper editors who delight in taking a nugget of truth and extrapolating incorrectly to produce a scare story that sells. For example:

> *March of the euro tax man—Daily Mail, 24 November 1998*
> The rush towards uniform taxes…could leave Britain facing the nightmare prospect of being forced to accept tax harmonisation as a condition of membership if we decide to join the euro…. It would mean not only interest rates but also key taxes being fixed in Frankfurt, the home of the new central bank.

> *Spectre of 53 per cent income tax*
> *—The Times, 28 November 1998*
> …bringing Britain into line with the other European nations would mean that a UK taxpayer would have to pay a further 30p in the pound. This would give a basic income tax rate of 53 per cent, against 23 per cent at present.

Both stories raise the spectre of EU-determined rates of income tax. Yet the European Union has no mandate to do this. Its governing treaties allow only for the 'harmonisation of legislation concerning…indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market.' Thus in 1991 EU ministers agreed to adopt, with many exemptions, a minimum standard rate of VAT of 15 per cent (the British minister who signed the proposal was the eurosceptic Norman Lamont), and minimum rates of excise duty on mineral oils, alcohol and tobacco. The same EU mandate was used to abolish customs duty within the free-trade area, and led to common-sense regulations to limit the double taxation of individuals across borders.

The European Commission believes that personal income tax is a matter for sovereign national parliaments, not European institutions. When Mr Lafontaine spoke of having similar income and corporate tax rates across the EU (so as to lessen the competitive pressure to reduce German taxes), he was doing no more than express a desire. Neither the German government nor the Commission—and certainly not the European Central Bank—has the power to do anything to translate that desire into practice.

> *Tax harmonisation 'may be irresistible'*
> *—Daily Telegraph, 27 November 1998*
> European politicians are demanding tax harmonisation because they say tax competition is 'harmful'.

> *EU may set rate of business tax*
> *—Daily Telegraph, 17 December 1998*
> British tax rates for business and industry could be set by Brussels under EU moves to co-ordinate taxes across Europe… New signs of British flexibility follow last weekend's Vienna summit at which Mr Blair and other leaders called for an EU Commission study into company taxation across Europe to be ready by June. The study, chaired by Dawn Primarolo, the Financial Secretary to the Treasury, is assessing the business tax regimes of member-states to reduce 'distortions' in the EU's single market and develop more 'employment-friendly tax structures'.

These stories—a *Daily Telegraph* speciality—deliberately confuse harmonisation with the removal of 'harmful' tax competition. It is true that a political committee known as the Code of Conduct Group, chaired by the British minister Dawn Primarolo, has been set up to seek out tax measures that 'unduly affect' where companies locate their business activities in the Union. The group's job, however, is not to harmonise rates across the EU. It is to level the playing field of competition, in this instance by preventing tax policy acting as a form of state subsidy to certain activities and industries at the expense of others within a national tax regime. The group's recommendations should complement the work of the Commission as enforcer of competition policy.

The EU is not alone in its efforts to crack down on 'harmful' tax competition. The World Trade Organisation, as recently as September 1999, confirmed that the common US corporate practice of avoiding tax by channelling export earnings through offshore companies, known as foreign sales corporations, amounted to an illegal subsidy that should be eliminated. If and when the US complies with this demand, it is the EU that stands to benefit. European countries should not complain when the same principle is applied to eliminate discriminatory tax breaks in their own continent. Hostility from the British press is particularly hollow, given that the conclusions of the Primarolo group are likely to benefit the UK: only a small handful of the several hundred taxation measures under consideration refer to Britain.

> *The German menace—Daily Telegraph, 26 November 1998*
> Chancellor Gerhard Schröder of Germany professes to be an

> Anglophile, but his government's agenda is starting to pose a serious threat to the prosperity and self-government of this country… If Mr Lafontaine wishes to ruin the German economy, that is a matter between him and the German people. If he tries to enlist Britain, we must resist.
>
> *Your country needs you to fight euro con*
> *—The People, 22 November 1998*
> Once the euro is in place the cry from Europhiles will be that it is now inevitable that we have a common tax policy, as Germany's new finance minister demanded grandly last week… If you want to stop this, act now. Refuse to accept the con that is inevitable. Write to your MP. Remind him of what the vast majority of politicians believed to be inevitable in 1939. Then, you could hardly get a hearing in Parliament if you opposed Chamberlain's appeasement policy. But it was the men who sold out at Munich who were proved wrong.
>
> *Is this the most dangerous man in Europe?*
> *—The Sun, 25 November 1998*
> Mr Lafontaine wants to increase your taxes, abolish your pound, allow a German central bank to fix your mortgage rate…he is the biggest threat to the British way of life since 1945.

Most of all, Mr Lafontaine's comments provided perfect ammunition for those papers happy to play on the jingoistic tendencies of some of their readers. The temptation to create a new German enemy, this time economic rather than military, was too much to resist for some newspaper editors.

In the popular press the word 'harmonisation' has been used very loosely. From total equalisation of all tax rates, to efforts to introduce EU-wide taxation on polluting companies in line with Kyoto environmental commitments, to moves to iron out discrepancies in accounting methods between countries, 'tax harmonisation' has become a catch-all cliché for the British media.

In reality these issues are all very different. They have different implications and merits, and have been pursued as a result of very different motivations. In fact one of the most cogent ways of assessing the various arguments for greater tax harmonisation is to classify the motivations behind them. The next four chapters examine the main arguments, namely: to boost the single market; to prevent erosion of tax revenues through competition; to prevent illegal tax evasion; and to protect the environment.

2 Reasons to harmonise I: to boost the single market

The single market case for tax harmonisation is based on the old economic argument that the better the market works, the better off we are. By removing barriers to trade between countries, competitive pressure on companies is intensified, forcing costs down and eliminating inefficient practices. The result—through the mechanism described more than two centuries ago by Adam Smith as the 'invisible hand'—is greater productive efficiency and therefore, according to the classical school of economics, greater economic wealth.

For a theoretical argument, this has been taken too literally in the past. The European Commission-funded Cecchini report of 1988, for example, attempted to quantify the effects of creating a European single market and concluded that it could lead to a 4.5 per cent increase in EU-wide GDP, with falling inflation. If combined with appropriate actions by governments, Cecchini added, that projection could be even more positive: a 7.5 per cent growth in the European economy, creating 5.7 million new jobs.

The Cecchini report was a landmark text because it succeeded in popularising, at least among policy-makers, ideas that had previously been confined to ivory towers. But it did not take long for its gung-ho approach to lose credibility. Its conclusions were soon seen as over-optimistic, arising from underlying economic assumptions of perfectly functioning markets that were too simplistic. A more credible study by the European Commission in 1996 (*The impact and effectiveness of the single market* COM(96) 520) indicated that the effect of the single market until then had been to create up to 900,000 jobs, to increase EU GDP by a total of between 1.1 per cent and 1.5 per cent in the period 1987-1993, and to cause inflation to fall by between 1 per cent and 1.5 per cent.

Common rates of tax boost the single market because they improve the ability of economic agents—consumers, investors or firms—to make decisions that are less affected by tax levels and more an accurate reflection of the real state of the economy. As a result, competitive pressure on companies is increased, driving out inefficient practices, lowering costs, and leading to greater economic wealth.

The arrival of the euro strengthens this economic rationale for common levels of taxation. A single European currency, by removing exchange-rate barriers to trade (the costs of hedging against adverse currency movements or currency-transaction charges), highlights distortions from other sources. Suddenly firms are able to make comparisons: once a company operates in the same currency across borders, the effects of different tax regimes become more obvious. Such effects might seem less significant in the face of large currency fluctuations that can wipe out profits overnight, but once exchange rates are fixed, dealing with discrepancies in the tax system becomes a higher priority.

However, this argument has limited relevance. It is only applicable where there is, or is reasonably expected to be, significant cross-border activity. Table 2 provides a back-of-the-envelope ranking of the main factors of production and general economic activity by cross-border mobility.

Table 2: Mobility of different factors of production

very mobile	*quite mobile*	*immobile*
• financial capital • trade in goods and services	• operations of large companies	• operations of small companies • labour • land and property

The single market will be boosted therefore by the removal of barriers to trade in goods and services, and by the cross-border movement of highly mobile capital, such as financial savings and investments. But where factors of production are relatively immobile between EU countries, as is the case with labour, land or small-business activity, little economic effect can be expected from the removal of cross-border barriers to trade.

There is, therefore, no single-market case for harmonising income tax, national insurance contributions and other labour taxes. But there is a case for aligning levels of taxation on cross-border movements of financial capital, and for similar levels of excise duties and VAT.

An interesting illustration is the decision by EU finance ministers in September 1999 to allow a lower rate of VAT on labour-intensive services. Member-states will be able to reduce VAT on certain transactions such as household repairs, the cost of renovating private homes (excluding expensive building materials), window-washing and domestic cleaning, home-help care and hairdressing. Because such services are not traded across borders and are labour intensive, to permit lower levels of VAT will not only boost employment but also do so without threatening to distort the single market.

Less clear-cut is the case of non-financial capital, the 'fixed' assets of large companies: plant, machinery and equipment. In one sense these are not fixed at all: until it is actually built, the production capacity of a multinational is mobile in that it could be located in a number of different places. But two caveats are needed. The first is that, unlike most purely financial transactions, an investment in fixed capital is immobile once it has taken place. Factories and office blocks cannot be moved around the globe at the press of a button. The response of companies to changes in the level of business taxes is, in economic terms, quite 'sticky'. A government can therefore increase corporation taxes safe in the knowledge that there will not be an immediate exodus of business activity.

This phenomenon has led some academics to conclude that policy-makers have every incentive to offer low levels of capital taxation in order to attract inward investment, but then slap on the taxes once the investment has been made.[1] In reality, however, that would have an impact, even if it was slow to emerge. Less profitable firms would go out of business and there might be a considerable shift abroad in the medium-term, led by the more mobile service-sector industries. Inevitably, there would also be a deterioration in the relationship between business and national government, which would prevent policy-makers from being able to pursue such a ploy again.

[1] *See, for example, K Rogoff, 'Journal of International Economics', 1985*

The second caveat is that decisions on where to invest in production facilities depend not only on the level of taxation but also on many other factors—quality of labour and infrastructure, transport links, availability of suppliers, market size, political risk, culture, language and so on—some of which are intangible. This is in contrast to financial investments, which are based on rates of return that are easy to calculate with precision. The effect that taxes have on inward investment decisions is therefore difficult to isolate.

In any case, were EU tax rates for companies to be equalised tomorrow, little economic benefit would follow. This is because what is treated as taxable varies hugely between member-states. There is little gain from harmonising tax rates when tax bases remain so different.

Tax bases differ across the EU in two fundamental ways: in the accountancy rules that firms must comply with, and in the extent to which governments offer tax exemptions to companies.

Accounting systems

When the European Commission conducted a survey of 13,000 European firms in 1996, it emerged that companies saw differences in tax regimes as one of the main barriers to the single market. National tax authorities often treat differently: depreciation rates of assets; costs of capital; methods of accounting for inflation when valuing stock inventories; provision for bad debts; and exchange-rate losses. Superficial similarities in headline tax rates between different countries may therefore mask substantial differences in the effects that taxation systems have on profitability. Were corporation tax rates to be instantly equalised, for example, there would still be a need for armies of expensive accountants, technicians and tax lawyers to enable multinationals to comply with (and in some cases, circumvent) the legal regulations in different countries.

Aside from the effect of different legal rules of tax accounting on corporate profitability, the lack of standard accounting conventions is itself a barrier. It makes it difficult for investors to understand and compare company data, and thus hampers the development of a single market in financial services.

During the 1960s and 1970s a series of European Commission reports proposed the Community-wide harmonisation of corporate tax systems by one method or another. All were designed, under Article 100 of the EU Treaty, to improve the operation of the common market. None was implemented. The proposal that got the farthest—a draft directive put forward in 1975—was blocked by the European Parliament in 1979 and eventually withdrawn in 1990. A committee was subsequently set up under the chairmanship of Dr Onno Ruding to investigate the disparities between member-states' corporation tax regimes. It inflamed debate by recommending, in 1992, specific minimum and maximum rates of corporate tax, in the context of parallel measures to eliminate discrepancies in accounting practices across the EU.

One possible way forward would be to give companies operating across borders the option of adopting a standard EU set of tax-accounting rules. That way, multinationals could operate under the same rules and systems throughout their accounts, while smaller domestic companies would be spared the upheaval of an obligatory change. The advantage of such a twin-track approach is that it would be self-selecting: companies that stood to gain from standardising their accounting information would adopt it; others would not. The difficulty would lie in agreeing what the accounting standard should be. Companies that do a high proportion of their business in one country would lobby the government of that country to push for its system to be adopted across the board. It is also not hard to envisage significant political resistance from some member-states, which would view it as a slippery slope to harmonised tax rates.

Tax exemptions

Another reason why an immediate equalisation of corporate tax rates would not be beneficial is the existence of considerable and varied tax exemptions in different member-states. So although the headline rate of corporate taxation in Germany is extremely high, the overall tax burden—the 'effective' rate—is far lower, thanks to extensive tax exemptions and government incentive schemes. As a proportion of GDP Germany raises less revenue from corporate taxation than Britain: 1.7 per cent of GDP in 1996, compared to 3.6 per cent in Britain and an average of 2.6 per cent across the EU, according to the EU's statistical agency Eurostat.

A Union-wide study of 3,000 companies by the University of Maastricht, published by the Dutch finance ministry in April 1999, detailed the extent of the discrepancies between headline corporate tax rates set by member-states and the effective rate paid by companies. EU firms pay an average 27 per cent tax on profits, despite the average headline rate being 36.5 per cent (see Table 3 below).

The need to investigate effective rates of taxation has not been lost on EU policy-makers. In July 1999, after six months of wrangling, member-states agreed the terms of reference for a European Commission enquiry into levels of effective taxation, to report by mid-2000. The mandate is broad. But the key lies in its intention to 'illuminate existing differences in effective corporate taxation in the Community and the policy issues that such differences may give rise to', with particular emphasis on 'the main tax provisions which may hamper cross-border economic activity and investment'. It will also look at the need to reform accountancy practices.

Table 3: The difference between headline and effective corporate tax rates 1990-1996 (%)

	Headline	*Effective*	*Difference*
Austria	36.02	17.67	18.35
Belgium	40.28	20.99	19.29
Denmark	35.78	29.40	6.38
Finland	34.02	29.82	4.20
France	34.70	32.82	1.88
Germany	50.05	38.53	11.52
Greece	32.53	20.85	11.68
Ireland	21.94	13.86	8.08
Italy	50.48	35.32	15.16
Luxembourg	39.40	34.09	5.31
Netherlands	35.00	31.80	3.20
Portugal	39.29	17.19	22.10
Spain	35.30	24.11	11.19
Sweden	28.54	27.47	1.07
UK	33.35	29.00	4.35
EU average	**36.45**	**26.86**	**9.59**

Source: *Corporate effective tax rates in the European Union*
University of Maastricht (for Dutch Finance Ministry), April 1999

The Commission will start by assessing existing work, including the study by the University of Maastricht, and will only undertake new research if obvious gaps appear. That does not mean the Commission intends merely to replicate the conclusions of work already in the public arena: it will be influenced by the opinions of two panels—one of business practitioners, the other of academics—set up to investigate the evidence. The size of the task makes this a tough assignment, but nevertheless extremely useful for enhancing the single market.

Unfair taxes and harmful competition

The issues of taxation and competition policy are closely linked in the EU. There is a critical distinction between 'fair' differences in tax treatment, which arise from the political priorities and macroeconomic policy decisions of national governments; and 'unfair' differences, which distort competition in a prejudicial way, similar to the operation of state aid. As the European Commission explains in its 1998 document *The application of state aid rules to measures relating to direct business taxation*:

> Article 92(1) states that 'any aid granted by a member-state through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between member-states, be incompatible with the common market'. In applying the Community rules on state aid, it is irrelevant whether the measure is a tax measure, since Article 92 applies to aid measures 'in any form whatsoever'.

The close relationship between state aid and company tax breaks allows the Commission, acting as the EU competition authority, to seek to smooth out distortions in the taxation treatment of companies through the Treaty of Rome's competition policy measures.

However, for the Commission to use these powers would be politically controversial. It has not yet been brave enough to do so. Instead, the Commission has encouraged countries to reach political agreement to clamp down on tax breaks operating as thinly disguised state aid. With this aim in mind, in 1997 it drew a distinction between 'harmful' tax competition, which distorts the single market, and that which was not.

Ireland's ability to poach investment by levying very low tax rates in certain sectors of its economy prompted other member-states to take an interest in the Commission's work. By December 1997 EU finance ministers had agreed to a Code of Conduct on business taxation, and set up the Code of Conduct Group, chaired by the British minister Dawn Primarolo, to single out cases where the taxation treatment of certain industries or companies could be considered 'harmful'. The methodology used by the Group to decide whether tax measures are 'harmful' is laid out in the box below.

When is taxation harmful?

The EU code of conduct on business taxation states that, when considering whether taxation measures are harmful, account should be taken of, *inter alia*:

- whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents, or
- whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base, or
- whether advantages are granted without any real economic activity or substantial economic presence within the member-state offering such tax advantages, or
- whether the basis of profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably those agreed upon within the OECD, or
- whether the tax measures lack transparency, including where statutory rules are relaxed at administrative level in a non-transparent way.

Source: Ecofin council conclusions 1 December 1997

There is no obligation on the Council of Ministers to publish the conclusions of the Code of Conduct Group, but its deliberations will have little effect unless the threat of publication is at least a credible one. The group has no legal status, deriving its power from its ability to bring strong peer pressure to bear on member-states to smooth out discrepancies in their taxation systems. Governments are encouraged to make progress from the knowledge that the Commission could pursue the same ends through legal means. Thus it is a carrot-and-stick approach: member-states are given a framework through which they can eliminate harmful taxation measures—and those of their neighbours—by political agreement; but if they fail, they could be pursued through the courts by the EU competition authorities.

There was a healthy momentum behind the activities of the Code of Conduct Group during 1999. But if, for whatever reason, governments fall at the final hurdle and fail to give a political commitment to translate the group's conclusions into action, the Commission should not have any qualms about using its competition policy powers to secure the same outcome.

In conclusion, there is a single-market case for similar levels of indirect tax, and for harmonising levels of tax on mobile financial capital. As regards corporate taxation, there are single-market grounds for a harmonised tax base across the EU. To that end, member-states should be prepared to allow the standardisation of accounting systems—but not of tax rates—to take place by qualified majority voting (QMV). At the very least, companies that operate across borders should be given the option of using EU-wide accounting standards, without prejudice to the national-based systems operated by smaller (and less mobile) domestic companies. The EU also needs to step up its efforts to eliminate tax exemptions that cause the effective rate of taxation to differ from the headline rate. Although the report of the Code of Conduct Group might well yield some results on business taxation, the European Commission should, in its role as competition authority, proactively investigate instances where tax breaks may be acting as state aid.

3 Reasons to harmonise II: to prevent revenue erosion

One of the strongest incentives for harmonising taxes is the fear that competition will prevent governments from raising sufficient tax revenues. Countries will simply undercut each other, the argument goes, poaching investment from their neighbours by offering lower tax rates, until company tax rates are forced down to zero. As a result, government coffers will wither away. In the long run, tax competition will create unemployment and threaten public services.

Tax competition and unemployment

The theory behind the fear of unemployment goes like this: as countries compete to attract private-sector investment, they cut business taxation and therefore have to compensate by increasing income tax or national insurance rates. As companies shed expensive staff in favour of more capital-intensive production methods, employment will fall.

This concern was highlighted in a paper presented to a meeting of EU finance ministers in Verona in April 1996 by Commissioner Mario Monti. The aim of the Monti paper was to consider taxation in the wider context of all EU policies; to pursue, in his words, a 'global approach' to tax policy. The paper noted that:

> the stability of total tax revenues has been achieved at the cost of a progressive alteration in the structure of taxation; the tax burden has been shifted to the less mobile tax base—labour—in order to recover the tax lost from the erosion of other more mobile tax bases.

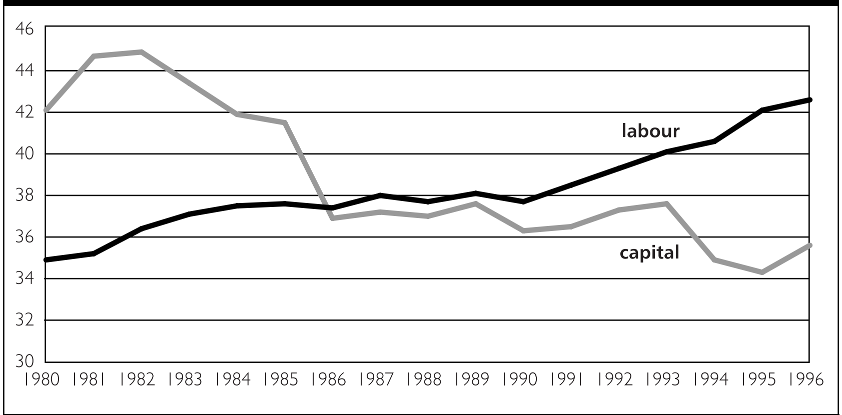
The implication is that the erosion of more mobile tax bases—capital and corporation tax—should be stemmed in order to prevent labour taxation from rising. Mr Monti's paper builds on the work of the 'Delors white paper', *Growth, competitiveness and employment: the challenges and ways* *forward into the 21st century*, presented by the European Commission to EU leaders in 1993. In that paper the Commission recommended that:

> it is essential to reduce the non-wage costs of unskilled and semi-skilled labour by an amount equivalent to 1 or 2 points of GNP by the year 2000. The improvement in tax revenue resulting from this measure would offset the cost by up to 30 per cent. The remainder should be financed by savings or other revenue.

Although not made explicit, the white paper gave ample scope to those in favour of tax harmonisation to argue that the 'other revenue' referred to company taxation, which they would fix at levels to prevent the erosion of overall government revenues.

On the surface this argument is convincing. Graph 1, based on figures published by Eurostat, shows that average labour taxes in the EU are rising, while taxes on capital have been falling since their peak in the early 1980s. (The 'implicit' tax rate is an average rate obtained by dividing the tax levied on each activity and/or production factor by the corresponding tax base. For example, the implicit labour tax rate is the total of non-wage labour costs divided by total income.)

GRAPH 1: LABOUR TAX RATES RISING, CAPITAL TAX RATES FALLING
IMPLICIT TAX RATE (%)



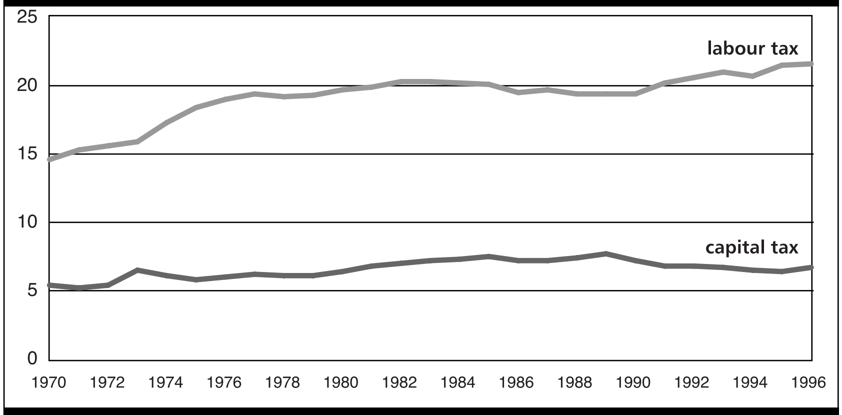
SOURCE: *STRUCTURES OF TAXATION SYSTEMS IN THE EUROPEAN UNION*
EUROSTAT/DG21

There is certainly a strong case to be made that the increase in labour taxes is a direct cause of unemployment. An empirical study published in 1997 by the Centre for Economic Policy Research (CEPR), for example, strongly supports this suggestion[2]. It argues that the bargaining power of unions in Europe has meant that increases in labour taxes have been borne not by employees but by firms. This has led firms to replace labour with capital, causing unemployment to rise. The paper's empirical results allow the authors to conclude that the 9.4 per cent rise in EU labour tax rates between 1965 and 1991 accounted for a four per cent rise in European unemployment.

[2] *F Daveri and G Tabellini, 'Unemployment, growth and taxation in industrial countries', CEPR Discussion Paper 1681, 1997*

But this rise in labour taxes has not occurred as a form of compensation for declining revenues from capital taxation. How could it, when the absolute sums of money raised from capital taxation have not fallen? The picture can be seen more clearly by looking at total tax receipts as a proportion of the overall size of the economy (see Graph 2). The data shows that revenues from capital taxes have remained broadly steady over the past two decades. So while revenues from labour taxation have gone up—from 17 per cent of GDP in 1970 to 24 per cent in 1996—there is no evidence that this has been to compensate for lower revenues from capital taxation.

GRAPH 2: REVENUE FROM LABOUR TAXES RISING, REVENUE FROM CAPITAL TAXES CONSTANT (% OF GDP)



SOURCE: *STRUCTURES OF TAXATION SYSTEMS IN THE EUROPEAN UNION* EUROSTAT/DG21

In fact, the higher revenues from labour taxation have fed through into higher overall levels of taxation: European Union taxes rose from 33.5 per cent of EU GDP in 1970 to 42.3 per cent in 1996. Thus, the imposition of a floor of minimum corporate taxes across the EU would not necessarily have the effect of reducing labour taxes and levels of unemployment.

So why do Graphs 1 and 2 show such different pictures? The answer is that the first graph shows taxation *rates*, the second taxation *revenues*. Advocates of minimum levels of corporate taxation confuse the two: in asserting the need to protect overall revenues, they illustrate their point with data on taxation rates. Yet there is no automatic relationship between the two concepts: higher rates do not automatically lead to higher revenues any more than lower rates do; the relationship depends on the elasticity of demand for the item in question.

It would seem that demand for labour is fairly elastic in the EU: higher implicit tax rates on labour are associated with lower levels of employment, but not so low as to cause a fall in overall tax revenues from labour. Indeed, to cut labour taxes might even achieve the dual benefit of raising government revenues while reducing unemployment through encouraging firms to switch back to labour from capital.

The real cause of high EU unemployment lies in the high total costs of labour: wage costs, non-wage costs and protective regulations. One reason these costs are prohibitively high, as the same CEPR paper (and many others before it) makes clear, is that the system of wage bargaining favours those in work rather than the whole workforce. It is a familiar insider-outsider debate: social protection and wages rise to benefit those in work (the 'insiders'); unemployment rises as a result, but that does not matter to the unions because they do not represent the unemployed (the 'outsiders'). The textbook solutions are either to centralise wage-bargaining arrangements so that negotiators are forced to take account of the effect of their demands on the national economy; or to decentralise radically so that negotiators have a direct interest in the profitability of the firm whose employees they represent, compared to that of its competitors. The current situation in many European countries, where employees negotiate on an industry-wide basis, does little to help their economies.

It is easy to make this argument from a British perspective, where much of the political and economic dislocation arising from an overhaul of the wage-bargaining process has already taken place, as a result of policies pursued vigorously by right-wing governments in the 1980s. The centre-left governments on the European continent would face significant political resistance if they advocated the same policies. Perhaps that is why it has been more attractive for some European politicians to advocate minimum levels of corporate taxation, rather than a shake-up of the wage-bargaining system, as a purported solution to the problem of high unemployment.

Tax competition and public services

Another fear is that tax competition will cause a fall in revenues, threatening public-sector budgets and forcing governments to cut back on essential services. Therefore, the argument goes, taxes should be harmonised, or at least their minimum rates fixed, in order to preserve the role of the state. This argument is particularly resonant in countries with relatively high levels of public investment and state-funded social protection. They fear they will be unable to compete in an international environment that favours low taxes. And rather than to go down the politically-troubled route of welfare reform, they argue for the fixing of corporate taxation at levels that will not threaten their own tax regimes. This was certainly the motivation behind the outbursts of the then German finance minister, Oskar Lafontaine, in late 1998. It is well illustrated by an extract from an essay[3] by his influential economic adviser, and deputy at the finance ministry, Heiner Flassbeck:

> The widely held view that nation-states should compete with each other is based on the same rationale as mercantilism—the idea that a country can only get richer to the detriment of others… But this 'competition of systems' is wrong and counterproductive if it takes place by depreciating a nation's costs—wages, taxes, regulations and public investment—in the manner of devaluing a nation's currency. As exchange rates are no longer an economic instrument in a single currency area, member-states might resort to this type of real devaluation in order to improve their competitiveness. Such a mercantilist strategy is not compatible with the functioning of proper European markets. The most important example of real depreciation is that of wage increases that are below

[3] *H Flassbeck 'Employment, stability and efficiency: the essentials of European economic policy' in "Will EMU lead to a European economic government?" Centre for European Reform, 1999*

> improvements in productivity. But real depreciation also takes place when the tax burden is artificially lowered, causing a reduction of public spending and the restriction of public services. Each strategy that aims at real depreciation is contrary to the idea of free trade. Within a single currency area, it is even destructive.

The idea that countries which lower the tax burden on companies so as to encourage private-sector investment are 'destructive' and acting 'contrary to the idea of free trade' is an excellent example of a pseudo-economic argument being used for political gain. One obvious fallacy is the assumption that lower company taxes produce lower public spending and reduced public services. On the contrary, lower tax rates could actually raise tax revenues by encouraging greater levels of business activity. The ensuing reduction in unemployment would, in addition, reduce government spending on social-security payments. A second fallacy is that companies' decisions are based on tax alone. In fact, the type of public investment that Mr Flassbeck espouses, such as in public infrastructure and education, could well be seen as attractive to investors, thereby compensating for higher marginal rates of corporate taxation.

Competition in taxation regimes does not lead inexorably to the erosion of public services, any more than harmonising corporate taxation is the solution to high unemployment. There is not much of a case, therefore, to argue that tax harmonisation is necessary to prevent government tax revenues from being eroded.

But such was the confusion caused by Mr Lafontaine and his advisers that his political master, Chancellor Gerhard Schröder, felt compelled in late 1998 to issue a clarification jointly with the British prime minister:

> We do not favour a unified system of corporate taxation…we will not support measures leading to a higher tax burden and jeopardising competitiveness and jobs in the EU.

In March 1999, not long after this hasty clarification, Mr Lafontaine resigned, followed in due course by Mr Flassbeck. It seems that, for the moment, *realpolitik* has put paid to this particular argument for EU-wide tax harmonisation.

4 Reasons to harmonise III: to prevent tax evasion

While the fear that governments will lose revenues through tax competition may be misplaced, there is little doubt that tax authorities do lose revenue as a result of illegal evasion. Where there are marked differences between tax regimes on mobile goods and services in neighbouring countries, there is a clear incentive to trade across borders in ways that reduce tax payments. To harmonise taxes across borders would go a long way towards eliminating this incentive.

There is a particularly powerful incentive for people to engage in cross-border arbitrage when the taxes on consumer goods vary substantially. The EU's single market programme increased the incentive by allowing individuals to import legally large quantities of goods across internal EU borders, without completing any paperwork or paying duty. Although such goods must, in theory, be for personal use only, this restriction has proved nigh-impossible to enforce. It is both simple and lucrative to buy off-the-shelf in low-tax regimes and sell illegally—off the back of a lorry, without paying tax—in high-tax regimes.

Britain suffers acutely from this problem: higher excise duties on tobacco and alcohol than in France and Belgium allow people to make large profits by importing goods across the Channel to sell on the black market. The result is lost revenues to the UK Treasury: in a parliamentary answer on 18 May 1999, the British government estimated lost excise duty and VAT from tobacco smuggling to be £1.7 billion in 1998—not far off the amount needed to knock a penny from the basic rate of income tax. Although this figure refers to *all* tobacco smuggling into the UK, not just that from the EU, cross-channel activity from France (whether or not the goods originated from farther afield) forms by far the largest part.

Official estimates of the total revenue lost to the UK Treasury from cross-channel smuggling of both tobacco and alcohol tell a similar story. A report by UK Customs and Excise in November 1998 estimated this at £1.22 billion in 1998, a very substantial figure that can be magnified if we assume that the smugglers are also unlikely to be paying corporate or personal income tax on the proceeds. Smuggling is also bad news for local retailers, which stand to lose trade as a result, leading to lower government revenues from corporation tax.

We saw in Chapter 2 that there is a good single-market case to harmonise indirect taxes—VAT and excise duty—on goods that are traded across borders. The argument here is that there is also a very strong case for tax convergence in order to clamp down on smuggling and illegal tax evasion.

Excise duties

Substantial differences persist in the rates of excise duty charged across the EU, as Table 4 on the next page shows. The indirect tax levied on cigarettes in the UK, for example, is double the rate in France; the UK tax on beer is six times as great; petrol duties are 30 per cent higher; and the tax on wine is more than 60 times greater in the UK than in France.

This is not for want of effort by the European Commission to iron out the differences. Minimum rates of duty have been introduced on a number of products, such as cigarettes and unleaded petrol. Although these have had the effect of forcing some countries to increase taxation to nearer the EU average, it has not stopped others from continuing to levy far higher duties. Similarly, EU attempts to iron out differences in beer duty by introducing a target rate have not always had the desired effect. Although the Council of Ministers agreed a target beer duty of €18.7 per hectolitre in 1992 (equal to less than a third of the rate of duty imposed by Britain at the time), the UK carried on increasing its beer duty in subsequent years. Between 1992 and 1999, Britain's beer duty increased by almost 18 per cent in current prices; it is now more than four times the EU target level.

With such good economic reasons to reduce differentials on excise duty, why do the governments of Britain, Denmark, Sweden and Finland persist in keeping their rates so high? The answer is that there are, in the eyes of governments, equally good political and social reasons for maintaining the status quo. Governments use excise duties to influence consumer behaviour. Britain, for example, believes that cigarette prices should be kept high as a way of curbing consumption in the interests of public health.

TABLE 4: DIFFERING RATES OF EXCISE DUTY (JULY 1999 UNLESS STATED)

	Still wine *€ per hectolitre standard, ex VAT*	*Unleaded petrol* *€ per 1,000 litres ex VAT*	*Beer* *€ per hectolitre 5% abv, 1 Jan 99*	*Cigarettes* *€ per 1,000, ex VAT*
Austria	0	406.89	6.70	66.58
Belgium	47.0	492.49	8.23	74.74
Germany	0	530.73	3.95	76.54
Denmark	141.56[1]	497.66	18.66	124.13
Greece	0	334.54[2]	5.86	51.00
Spain	0	402.59[3]	3.36	35.43
Finland	234.71	558.78[4]	57.36	107.30
France	3.35	584.75	5.20	86.24
UK	214.32	751.30[5]	32.67	171.64
Ireland	287.57	477.76[6]	39.92	120.05
Italy	0	541.56	7.02	55.38
Luxembourg	0	346.55	3.80	52.72
Netherlands	48.70	471.68	8.54	69.12
Portugal	0	477.15	5.64	56.72
Sweden	292.97	484.69	31.03	97.54
EU minimum	**0**	**287**	**18.7**[7]	**57% of total price**

[1]over 15% vol; [2]over 95.6 octane; [3]over 97 octane; [4]normal; [5]super; [6]high-octane; [7]target

SOURCE: EUROPEAN COMMISSION; BASS PLC

A further explanation of differential duties lies in the diverse economic structures of EU countries. Those member-states with significant wine (and, to a lesser extent, tobacco) industries are subject to greater lobbying from local producers to keep prices down. In the northern states, where such goods have to be imported, the health lobbies have a stronger voice.

Value-added tax

There are still significant variations in levels of VAT among EU member-states, despite the attempts of the European Commission to bring them into line. In 1991 EU ministers agreed to set a standard minimum of 15 per cent in all countries and to eliminate higher VAT bands. Reduced rates of five per cent were permitted for essential items not traded across national borders. Britain was allowed to keep its even lower VAT rates, including zero rating on children's clothes. These exemptions had to have been in place before December 1991; member-states agreed not to introduce any new exemptions. Nevertheless, as Table 5 shows, beyond an across-the-board rise of a couple of percentage points in the past ten years or so, any convergence of standard VAT rates across the EU has been slight.

There remain political reasons for different levels of VAT. The UK uses indirect taxation to perform functions normally assigned to welfare policy in other countries. Britain's insistence on zero-rated VAT on children's

TABLE 5: STANDARD VAT RATES RISING, HARDLY CONVERGING (%)

	1987	*1999*		*1987*	*1999*
Belgium	19	21	Netherlands	18.5	17.5
Denmark	22	25	Austria	-	20
Germany	14	16	Portugal	17	17
Greece	18	18	Finland	-	22
Spain	12	16	Sweden	-	25
France	18.6	20.6	UK	15	17.5
Ireland	21	21			
Italy	19	20	average	17.2	19.4
Luxembourg	12	15	SD*	3.3	3.1

** standard deviation—a measure of the dispersion from the average*

SOURCE: DICK LEONARD *GUIDE TO THE EUROPEAN UNION* ECONOMIST PUBLICATIONS 1998; EUROPEAN COMMISSION clothes, food and books, and on the lowest possible rate for domestic-fuel consumption, is equivalent to other nations' use of food vouchers and higher social-security benefits to assist the least well-off.

TABLE 6: THE MANY WAYS TO RAISE MONEY
TAX REVENUES AS A % OF GDP (1996)

	indirect tax	*income tax*	*corporate tax*	*social contributions*	*Total inc others*
Belgium	12.8	14.6	3.1	15.2	46.3
Denmark	19.0	24.4	3.8	1.7	53.1
Germany	12.7	8.2	1.7	18.7	42.0
Greece	14.8	4.7	2.0	9.7	31.6
Spain	10.8	8.4	2.0	12.9	35.5
France	15.6	7.9	1.8	19.7	45.9
Ireland	14.3	10.6	3.5	4.7	33.3
Italy	12.5	9.5	4.2	14.8	42.9
Luxembourg	17.5	9.9	4.4	11.9	44.7
Netherlands	13.2	8.4	4.1	18.0	44.8
Austria	15.6	9.3	1.8	15.4	44.2
Portugal	15.2	6.9	2.6	11.7	37.1
Finland	14.5	16.5	2.9	14.0	48.2
Sweden	16.5	19.2	3.1	15.2	54.1
UK	14.7	10.6	3.6	6.3	35.6
EU-15	13.6	9.6	2.6	15.3	42.3

SOURCE: *STRUCTURES OF TAXATION SYSTEMS IN THE EUROPEAN UNION 1970-1996*
EUROSTAT/DG21

The differing uses of taxation also constitute a hurdle to the further harmonisation of VAT. The way in which the state raises its revenues varies substantially across the EU, as Table 6 shows. Denmark, for example, uses revenues from VAT to cross-subsidise other areas of government activity, making up for its lower-than-average level of social-security contributions. Denmark would find it politically difficult to harmonise its VAT rates to the EU average because it would need either a very obvious increase in labour taxation or a dramatic cut in welfare payments. Other countries would have similar problems, to a lesser or greater degree.

Withholding tax

Differences in the ways that member-states tax income from financial investments has led many people to hold their savings abroad, as a means of avoiding domestic taxes. In Germany, for example, high-street banks have faced legal action following allegations that they routinely advised customers to transfer their savings abroad. Strong banking-secrecy laws in neighbouring Luxembourg mean that Germans can invest there, fairly confident that they can hide the income from the German tax authorities. The German state prosecution service believes there may be half a million cases of illegal earnings from tax evasion by private investors. The Belgian tax authorities face a comparable problem of lost revenue.

There are two potential solutions. The first is for countries to share information about who is investing where. By co-operating, national tax authorities can alert each other to income earned by cross-border investors. The second solution is for national authorities to slap a tax on income earned by private investors who are based in another country. Such a tax is known in the jargon as a 'withholding tax', defined as any tax deducted from payments (usually deriving from investment income) to non-residents. A withholding tax would diminish the incentive for private savers to invest outside their own borders, making it easier for national tax authorities to keep tabs on who was earning what.

Among the EU member-states each of these options has its supporters and opponents. Least popular is the idea of sharing information between tax authorities: for a number of countries this threatens their culture of bank secrecy. Luxembourg has an explicit legislative provision for banking secrecy, Austria has recently enshrined it in the constitution, and in Germany tax authorities may not request information on bank accounts to verify the correct reporting of interest. Other countries, such as Belgium, Spain and Portugal, allow information to be given if there is a suspicion of fraud; but only a handful, including the UK, have legislation requiring banks to give access to the tax authorities.

Most member-states support a withholding tax, as it would bring greater revenues to their national tax authorities. But there are two exceptions: Luxembourg and the UK. Luxembourg's objection is straightforward: if it lost foreign investors, its banks—which are crucial to its economic success—would suffer. It vetoed a similar proposal put forward ten years ago. In Britain, the City of London argues that the extra burden of administering a withholding tax would threaten its high-volume, low-margin international bond business by increasing transaction costs and thus driving it to markets outside the EU, such as New York or Zurich.

Since any EU-wide initiative on taxation policy requires unanimity, the European Commission has tried hard to find a compromise acceptable to everyone. In May 1998 it published a draft directive that would give member-states the option to either introduce a withholding tax of at least 20 per cent on income earned by non-resident private savers, or provide other EU tax authorities with information on who is investing in their banks and financial markets. The directive would allow most member-states to have a withholding tax while Britain and Luxembourg shared information with other tax authorities.

Under this proposal every country apart from Britain and Luxembourg would gain in two ways: increased revenue from the new tax, and an opportunity to clamp down on tax evasion within their own borders thanks to the extra information provided. Britain and Luxembourg, by contrast, would end up simply increasing their administrative costs by having to provide information to other countries. In the City of London, financial institutions argued loudly that the costs of sharing information would be just as damaging as the costs of administering a withholding tax.

The City, however, is protesting too much. It makes much of its money from trading international bonds, known as "Eurobonds". But retail holdings of Eurobonds are only around five per cent of total holdings. The remainder are held by institutional investors and would not be subject to the withholding tax. Furthermore, holdings of non-resident investors are a fraction of the total retail market. To complain—as the City has—that the whole of the London Eurobond market is under threat from the proposal is an exaggeration. The City would certainly suffer some net cost if the Commission's draft directive were implemented, so it is understandable that it chooses to press its case forcefully. But no one should be under the illusion that the adoption of a withholding tax or the sharing of information between authorities poses a serious threat to London's dominance of the Eurobond market.

There are some other, more technical aspects of the 1998 draft directive, however, that do require attention. One concern is the need to find legal definitions of the types of securities to which it applies, and of the financial institutions that would be responsible for administering any tax. Otherwise, the directive could create an incentive for the invention of new types of securities and trading entities, in order to avoid taxation. Another very serious problem is that many existing international bonds contain a clause that covers the possibility of a new tax being introduced before the bond reaches maturity. This usually gives the issuer a choice either to compensate the investor for the tax (known as 'grossing-up'), or to redeem the entire issue at its face value. As interest rates have been falling for some time, a large number of outstanding bond issues are trading at a price higher than their original value, which would make it profitable for many issuers simply to redeem at face value. The ensuing redistribution of assets would cause massive market disruption and uncertainty.

Both concerns need to be addressed before the directive is adopted, which means that the 1998 draft needs rewriting. In September 1999 Britain suggested two ways of doing this. First, the directive could exempt from the tax all existing bonds, all future bonds that are held in a clearing system, and all holdings above €40,000. This, Britain argues, would prevent the mass redemption at par of existing bonds and allow the wholesale market of the City of London to continue trading relatively unscathed. Second, the directive should specify which types of assets it applied to, rather than which types it excluded, thereby targeting retail investors more directly.

Although the British paper was not particularly well-received (the German finance minister, Hans Eichel, described it as 'totally insufficient'), it did represent a step forward in the negotiating process. For a start, it persuaded other EU countries to accept that, were a withholding tax to be introduced, it should apply only to new bonds, so as to avoid the problem of a mass redemption of bonds at their face value. Moreover, it allowed other countries to understand the UK's point of view fully, even if they did not agree with it. Based on this understanding of Britain's concerns, the European Commission, in conjunction with the Finnish presidency of the EU, came up with a compromise proposal in the few days before the Helsinki summit of December 1999. This compromise reduced the amount of information that would have to be provided by the City financial institutions to the level already required under an existing money-laundering directive—namely the account number and name of the non-resident.

If accepted, this compromise proposal would allow the UK to opt to share information with other EU tax authorities at an extremely low cost. Other EU countries, meanwhile, would still be free to impose a withholding tax. In the event, however, this last-minute proposal was not good enough for Tony Blair and Gordon Brown. Whether the problem was lack of time to study the proposal, or a sudden concern that the whole directive was fundamentally flawed, or simply grumpiness derived from France's refusal to lift the ban on British beef, they would not agree to it. Instead the whole decision was postponed for a further six months, ostensibly to give the UK more time to consider.

Even if agreed, an EU savings directive would not prevent individual investors who want to cheat their national tax authorities from turning to markets outside the EU, such as Zurich or New York. Indeed there is no particular reason why the problem of cross-border tax avoidance on income earned from financial investments should be tackled at an EU level, rather than by an international body. A voluntary agreement by OECD countries to operate common rates of taxation on income earned by non-resident investors, or to disclose income earned by non-residents to domestic tax authorities, would be more effective than an EU directive. But in the absence of unanimity among all OECD governments as to the merits of such a scheme, agreement is unlikely. After all, the OECD is only a think-tank of which individual countries are members; it has no legislative powers. The advantage of taking action at an EU level is the purely practical reason that there is some hope of an agreement being reached, and that that may spur other OECD countries to follow suit. However, the Commission's 1998 proposal clearly needs substantial revisions in order to gain the support of all EU countries.

5 Reasons to harmonise IV: to protect the environment

The issue of environmental taxation deserves to be dealt with separately. Although many of the environmentally-driven arguments for tax harmonisation sound familiar—for example to prevent distortions to the single market and to promote an employment-friendly tax structure—in one key respect this debate is very different. It operates on the premise that higher taxes on polluting activities are, all else being equal, better for the environment.

The point of environmental taxation is to ensure that the market prices of goods and services reflect their full costs to society. It is about prices telling the truth. A polluting factory may do a roaring trade for many years but leave behind contaminated land, air and water which future generations have to pay to clean up. But if the factory is taxed for each truckload of waste that it dumps, not only will it have an immediate incentive to invest in cleaner technology, but also the state gains income which it can spend on helping future generations meet the clean-up costs. Thus the cost to the environment will have been 'internalised' within the decision-making process of the polluter. Similarly, taxes on the use of energy can make consumers take into account the effects of their actions on the environment. The key concept is to make the polluter pay for the environmental damage he causes: it puts a market price on environmental pollution, creating an immediate incentive today to minimise the costs society will incur tomorrow.

Economic theory aside, there are practical justifications for levying environmental taxes. They tend to be straightforward to administer, and can be more acceptable to voters than other taxes. They can be adjusted with relative ease, to achieve the level of taxation that is needed to alter behaviour. They also create a market for cleaner forms of technology, boosting investment and employment in high-tech industries. Furthermore, higher environmental taxes can also give governments the freedom to cut taxes elsewhere to benefit the economy. The 1993 Delors white paper, for example, advocated a shift from labour taxes to environmental taxes, to achieve the twin virtues of boosting employment while simultaneously improving the protection of the environment.

It is difficult to argue against higher environmental taxation. But that is not the same thing as arguing for *harmonised* taxation. Environmentalists often, wrongly, use 'harmonisation' as a synonym for common minimum rates of taxation on certain products. Advocates of harmonised tax rates might be equally happy were the rate fixed at 10 per cent or 40 per cent. Advocates of minimum tax rates would prefer the rate to be set high, so as to have the greatest possible effect on the decision-making of economic agents, be they firms or households. There is an environmental case for high minimum rates of environmental tax, but not for harmonised rates.

Yet the European Commission's recent efforts to broaden the areas to which minimum rates of environmental taxation apply should still be supported. The current proposal, the brainchild of Mario Monti, would ratchet up the existing minimum rate of tax levied on mineral oils, and extend minimum rates to coal, natural gas and electricity. Although environmental groups in northern Europe have criticised the proposal for not being radical enough—for many countries the EU's proposed tax would still be below national levels—the setting of minimum levels would establish an important principle and would create the possibility of those levels being raised at a later date. So the main reason for supporting this proposal is that it is a means to achieving higher levels of tax. In the context of environmental policy, minimum taxes are not an end in themselves.

Spillover effects

Because pollution does not respect national borders, EU member-states have a legitimate interest in each other's environmental policies. The 1986 explosion at the Chernobyl nuclear-power station in Ukraine affected much of Europe; any country's greenhouse-gas emissions contribute to overall climate change; a factory that pollutes the Danube upstream in Germany will affect water quality downstream in Austria; the Irish rightly assert their interest in any contaminating effects of substances dumped in the Irish Sea by the Sellafield nuclear reprocessing plant in Cumbria.

It is these 'spillover effects' that give any international body a mandate to tackle environmental concerns. For the EU, they provide part of the justification for its governing treaties to state that economic and social progress should take into account 'the principle of sustainable development' and that its activities shall include 'a policy in the sphere of the environment' with the objectives of 'preserving, protecting and improving the quality of the environment; protecting human health; prudent and rational utilisation of natural resources; promoting measures at international level to deal with regional or world-wide environmental problems' and 'taking as its base a high level of protection'.

The EU is the right institution to promote environmental protection not only within its borders but also on the world stage. It signed, in its own right, the 1992 Rio declaration on global environmental development, and the protocol on climate change agreed at Kyoto in 1997. As an organisation, the EU has therefore committed itself to addressing global warming and—if the Kyoto protocol ever comes into force—to specific targets for reducing the emissions of the main six greenhouse gases by eight per cent below 1990 levels in the period 2008-2012.

Another argument for EU-level action is that it might persuade otherwise recalcitrant member-states to attach greater importance to environmental issues. The Monti draft directive, if adopted, would lead to some rises in energy taxes: 1998 figures from the European Commission indicate that petrol and diesel prices in Greece, Luxembourg and Spain would have to rise by between 6 and 11 per cent as a result of the increased tax on mineral oils. It would also introduce a tax on coal in Britain and Germany—a fuel which to date has received a subsidy—and a tax on gas in many EU countries.

But the prospect of higher tax rates may scupper the proposal: Spain has lobbied hard against the tax, arguing that its effect would be inflationary and damaging to industry. The Commission counters that any member-state is free to use the revenue generated to reduce taxes elsewhere, which could be deflationary, and if used to lower labour taxes, could be good for business and employment. But because all taxation measures are subject to unanimity, Spain has been able to stall progress by threatening to use its veto. The UK was opposed under the Conservatives but has softened its line under Labour. It is now supportive in principle, provided it can obtain a guaranteed permanent exemption for domestic gas and electricity; the regressive nature of domestic energy taxation makes it unpopular in Britain.

If the Monti directive fails, those member-states that do support it—mainly the northern EU countries—may try to reach their own agreement. In September 1999, the environment committee of the European Parliament proposed a kind of 'energy-tax Schengen', to allow the Monti proposals to move forward without Spain. Backed by the Finnish environment minister, Satu Hassi, MEPs suggested that those countries in favour of the Monti directive could invoke Article 11 of the Treaty of Amsterdam. This allows a group of EU member-states to push ahead with policy initiatives if an EU-wide agreement cannot be found. Germany might well favour this approach: it could then increase its own energy taxes in tandem with its northern European neighbours, and so moderate business concerns that higher environmental taxes would undermine competitiveness.

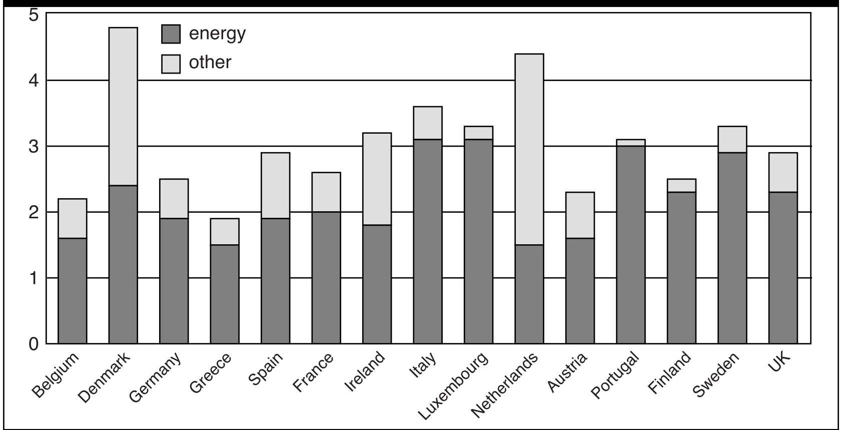
Whatever happens to the Monti proposal, many European countries will continue to favour a common approach to environmental taxation, for the simple reason that there are large differences in the scope of energy and environmental taxes across the EU. An OECD study from 1997 shows Sweden, Denmark and Finland with more than 20 kinds of environmental tax, closely followed by Belgium and the Netherlands. Greece, Ireland, Italy and Luxembourg lag behind with only a handful. The importance of energy and other environmental taxes (such as taxes on waste) to the member states' finances varies significantly, as the chart on the next page shows.

The desire to harmonise, rather than simply to raise environmental taxes, is based on the assumption that the existence of very different systems in the EU must cause economic distortions.

Preserving a single market

The first set of arguments in favour of environmental tax harmonisation relates to the single market. Just as significant differences in excise duties on alcohol and tobacco lead to market distortions (see Chapter 2), so large differences in environmental excise duties on tradable consumer goods also distort economic decision-making. One illustration is a problem that occurred on the Dutch/German border: higher fuel prices in the

CHART 1: DIFFERENCES IN ENVIRONMENTAL TAXATION
% OF GDP (1996)



SOURCE: *STRUCTURES OF TAXATION SYSTEMS IN THE EUROPEAN UNION*
EUROSTAT/DG21

Netherlands encouraged 'tank tourism' to Germany. The same phenomenon occurs on the border between Northern Ireland and the Irish Republic, all around Luxembourg and, to a lesser extent, between Britain and France. The argument that there is a single-market case to harmonise VAT and excise duties on goods traded across borders applies just as strongly to indirect taxes levied in the interests of the environment. But this is not quite what many environmentalists want to hear: in theory there is just as much of a single-market case to harmonise consumer excise duties downwards as upwards.

A similar argument applies to environmental taxes paid by firms as consumers of energy. As businesses in high-tax countries are fond of pointing out to governments, there is a single-market rationale to harmonise excise taxes on energy use. But (as explained in Chapter 3) since business activity is only partially mobile, and since environmental taxes are only one of a number of factors that influences a company's choice of where to invest, this single-market case is not very strong. The Institute for Public Policy Research has pointed out[5] that the changes in industrial costs arising from environmental taxes will be, for most sectors, a very small proportion of overall costs. The same study pointed to a 1993 OECD report, *Environmental Policies and Industrial Competitiveness*, which

[5] *S Tindale & G Holtham "Green tax reform: pollution payments and labour tax cuts" IPPR, 1996*

concluded that there had been 'little or no impact on the overall competitiveness of countries' from environmental taxation. Similarly, the immobility of domestic households (equivalent to the immobility of labour identified in Table 2, page 10 above) removes any single-market rationale for harmonising taxes on the consumption of electricity or gas in the home. By contrast, the cross-border nature of international travel means that an EU-wide tax on aviation fuel should be supported; a further justification is that EU aviation fuel is purchased duty-free, which discriminates against international road and rail travel.

Ensuring a level playing field

This leads us to the second economic argument in favour of harmonised environmental taxes, which relates to competition policy. As explained in Chapter 2, the Commission, acting as the EU competition authority, may pursue governments which grant state aid and tax breaks to specific industries. Strictly, the same principle should apply when the state aid forms part of a government's environmental policy, such as aid to promote research and development into environmentally friendly technologies, or tax breaks to promote energy-efficient methods of production. However, the EU takes the view that the advantages to the environment from such measures outweigh any potential economic disadvantages. In its official clarification of the relationship between state aid and business taxation, the Commission states that 'tax incentives for environmental, R&D or training investment favour only the firms which undertake such investment, but…do not necessarily constitute state aid'.

Indeed the Commission has given the all-clear to a German plan to shift the burden of taxes from labour to polluting activities, despite the provision of numerous tax exemptions to certain companies covered by the plan. In some cases, at least, the Commission believes that environmental protection is preferable to a perfectly functioning single market.

Applying political pressure

Perhaps the greatest benefit of discussing environmental taxation is that it forces governments to take all their policies on the environment more seriously. By raising the sensitive issue of harmonisation, the EU will force countries that oppose it to show why harmonisation is not necessary. Governments will have to demonstrate, for example, that they are already meeting their Kyoto obligations, without the EU needing to force the pace of change. Only by pushing strongly for higher EU taxes on pollution will environmentally-conscious governments be able to increase pressure on the others.

For this reason the next intergovernmental conference (IGC) should discuss whether to scrap the unanimity rule for environmental taxation measures. Countries in northern Europe that want faster progress towards an EU-wide environment policy should push for this treaty revision—as indeed the Nordics did at the last IGC. Economic instruments such as taxes are often a more efficient way of meeting environmental goals than regulation. At the moment, EU actions remain largely regulatory, precisely because this allows for decision-making by qualified majority voting. So the extension of QMV to environmental taxation would give the EU a broader range of environmental policy instruments. And even if—as is likely—there is no consensus for that extension of QMV, the mere fact that it was on the agenda would force countries to think more seriously about environmental policy commitments.

6 Prospects for 2000 and beyond

The year 1999 was supposed to be the year in which European governments did a deal on taxation policy. They had said as much in 1997, setting a deadline of the Helsinki summit in December 1999 to achieve their ambition. The European Commission pushed strongly for a deal, having invested considerable energy in a package that—it thought—had something in it for everyone. The Commission stressed the all-or-nothing nature of the proposal: governments could not pick and choose between individual parts of the deal on the table. All the ingredients for a successful outcome therefore seemed in place—a deadline, political will and a broadly-based package. Yet no deal was reached.

The package foundered because Britain could not be convinced that the proposed directive on tax evasion would not damage the City of London (see pages 29-32). Britain's hostility was well known; the UK had minuted its objections when the withholding tax had been proposed several years earlier. The Commission's tactic for dealing with Britain's objections was two-fold. First, to negotiate with both the British government and the City to try and accommodate their concerns. The original proposal was significantly modified during the course of 1999, indicating a real willingness on the part of the Commission to take account of British interests.

The second tactic was to package the savings directive with other measures that the UK wanted to see enacted. In that way, there would be real costs to Britain if it vetoed the package, beyond the embarrassment of blocking a measure supported by most of its partners. With this aim in mind, Commissioner Mario Monti put together a package with three distinct parts:

★ a directive on the taxation of cross-border payments of interest and royalties between associated companies;

★ the final report of the Code of Conduct Group on business taxation; and,

★ the directive on the taxation of savings.

The first of these is the least contentious, benefiting not only Britain but also all other EU member states. Its aim is to ensure that companies that are formally associated—such as subsidiaries of the same holding company or partners in a joint venture—should not have to pay tax on inter-company transfers of interest and royalty payments. It is a measure that is supported by international business, and its adoption would have a marginal net effect on national treasuries. Thus any government that brought down the package would risk the displeasure of its business sector back home.

The second proposal, the final report of the Code of Conduct Group, is in itself a package of measures (see pages 16-17). While one country may strongly oppose one item in the group's conclusions, it will probably support most of the rest. The overall effect, therefore, is that most countries support most measures: a good starting point for an all-or-nothing agreement. The deliberations of the Code of Conduct Group are strictly secret, although the list of items under consideration has been published. The group did come to an agreement in the run-up to the Helsinki summit, but the absence of an overall deal means that the terms of that agreement are not in the public domain. From what can be gleaned, however, the main losers are likely to be Ireland, the Netherlands, Belgium, Spain and, to a lesser extent, France. They all have tax policies that other countries consider 'harmful' under the definition adopted by the group, for example in relation to intra-company transactions, or in the preferential way they tax financial services.

Britain has probably come off well from the conclusions of the group. Few aspects of its tax system were under investigation, and the fact that the group managed to come to an agreement is a credit to its chair, the British Treasury minister, Dawn Primarolo. The UK has come under strong pressure to eliminate the tax havens in the Channel Islands and the Isle of Man, but in reality it has little power to do so: these parts of the UK operate their own investment laws and are not within the European Union. The British government can promise to lobby for change, yet blame the local administrations if it is unsuccessful. Meanwhile, British business would benefit from the Code of Conduct Group forcing other members to scrap the bits of their tax systems that give competitor companies an unfair advantage.

For this reason, the Commission had hoped that Britain would accept a watered-down version of its withholding tax proposals. In vain. And since EU tax policy needs to be agreed by unanimity, one country's hostility was enough to ensure that no deal would be reached. In Helsinki, therefore, member-states could agree only on a "high level working group" that would try to forge an agreement on the withholding tax by June 2000.

Prospects for Portugal

On balance, it looks unlikely that there will be an agreement on the Monti three-prong package by the end of the Portugese presidency in June 2000. The final deal on the table in Helsinki actually appeared to meet virtually all the concerns of the City of London. It should have been the spin-doctor's dream. The package would have allowed the British prime minister, Tony Blair, to tell the media that (a) he had prevented a tax being imposed on Eurobond income, just as he had promised; (b) he had fought constructively on the European stage in Britain's interests; (c) he had prevented the City from being harmed by a huge extra administrative burden since the new reporting requirements were no more onorous than existing regulations; (d) other EU countries had been forced to get rid of unfair tax advantages, and that this had been achieved by an EU-wide committee chaired by a British minister. Instead Britain prevented a deal from being struck.

If the proposed deal at Helsinki was not good enough, it is hard to think of any further compromise that will improve it. And since most other member states will not agree to the first two prongs of the package unless the UK agrees to the third, the prospects for any tax deal at the Portugese summit appear remote. More likely is that the directive on the taxation of savings will fall, as will the conclusions of the Code of Conduct Group. The uncontentious nature of the directive on the taxation of cross-border payments of interest and royalties means that it will probably be agreed at some stage, but only when everyone agrees that the prospects for a larger deal appear slim.

In the longer term, however, all will not have been lost. The process of the Code of Conduct Group will have alerted member-states more clearly to the fact that many of their own tax measures are considered unacceptable to their neighbours. This may help to make countries more amenable to reversing them. Nor will Mr Monti let the issue go. His new job as the EU Commissioner for competition policy will give him plenty of scope to push governments to eliminate the anti-competitive tax measures identified by the Code of Conduct Group. He may have to resort to EU rules on competition policy rather than political agreement. The new single market commissioner, Frits Bolkestein, seems likely to support Mr Monti in this endeavour.

Even if the withholding tax proposal is dropped, EU countries will still come under pressure to share more information with neighbouring tax authorities. The OECD will publish a report in June 2000 that defines as a “tax haven” any country that does not tax foreigners and does not share information with other tax authorities. Many EU countries will be listed as tax havens under this definition, which might put pressure on them to loosen their secrecy laws, even without an EU-wide directive. But there is no reason to think that this process will be at all speedy. In the words of an aggrieved Mr Bolkestein after the Helsinki summit, waiting for agreement at a world level “would be like waiting for hell to freeze over”.

The intergovernmental conference

The year 2000 will also see an inter-governmental conference (IGC) where the governments will discuss which parts of the EU’s constituent treaties need revision. The main point of the IGC is to enable the structures of the EU to cope with an expanded Union of, perhaps, nearly 30 members. As such, the IGC’s mandate does not deal directly with tax matters. But it will consider whether qualified majority voting should he extended into some of those areas, such as taxation policy, that are currently subject to unanimity.

The member-states will need to work out what exactly it is they want from an EU-wide taxation policy. If they want to harmonise tax rates across the EU, then they will have to change the voting system. After all, if the simplest proposition, such as a watered down proposal for (extremely low) minimum rates of energy tax, founders because 15 countries cannot agree, how could 25-30 members ever agree on anything? But the evidence is that most countries do not want a common tax policy explicitly to harmonise rates of taxation. In which case they should use the opportunity of the IGC to decide what they do want their tax policy to do, and proceed accordingly.

This pamphlet has argued that even if there is a good economic case for harmonising VAT and excise duties, and a common withholding tax, and a good environmental case for minimum rates of energy taxation, the political barriers to significant convergence remain high. So the EU should not adopt QMV for the setting of minimum rates of tax on VAT, excise duties or savings (or, arguably, on energy). It is more important for the EU to remove the remaining regulatory hurdles to cross-border business, rather than rush into the politically charged arena of tax rates. But to enable the Commission to do its job properly in this more limited field, member-states should agree to extend QMV to technical measures affecting tax bases.

The best way forward at the IGC would therefore be to make a clear distinction in the treaty between voting on technical decisions to harmonise rules and regulations to make the single market work better; and decisions that affect tax rates. QMV would apply to the former area, and unanimity to the latter. That would allow the Commission to concentrate on its more technocratic function as the competition authority of an increasingly competitive single market, and to have some hope of achieving agreement on its proposals. Rather than waste its limited resources in any futile pursuit of harmonised tax rates, the Commission should concentrate on the rules and regulations, removing the considerable non-price distortions that still exist.

The impact of the euro

In the long term, the arrival of the euro will probably have a bigger effect on the tax policies of EU governments than the wranglings over tax during 1999.

The launch of the euro does not make harmonised tax rates an inevitability, but it will eventually lead to pressure for greater voluntary convergence. The full effect of the euro on the operation of the single market has not yet been felt. When all transactions are conducted in euro, and consumers—be they businesses or individuals—get used to looking abroad to get the best deal, the tax treatment of business in a single-currency zone will become a more important issue. The single currency will make more obvious the remaining regulatory barriers to the internal market, and policy-makers at national and EU level will come under increasing pressure from business to remove them.

Governments with particularly onerous accounting regulations will be lobbied strongly by their companies to change them. Countries that grant tax exemptions to favoured industries will be lobbied even more fiercely by other member-states with similar industries to eradicate them. It will become more urgent to have common accounting standards and EU institutions will be best placed to co-ordinate the necessary changes. The more competitive environment will focus minds on the real effects that different tax bases have on company profitability, and away from a discussion of headline rates. In this way, over time, economic and monetary union will lead to a proactive and deliberate harmonisation of the regulatory environment for European businesses. This is to be welcomed.

Only when tax bases are more similar will differing rates of taxation really start to affect competitiveness. As all else becomes more equal, companies will place greater emphasis on tax rates when deciding where to invest. The convergence in business operating conditions will allow companies to become more mobile—it will matter less which country they operate in—and in consequence differing tax rates will become more significant. (The same will not be true of personal income tax: differing cultural conditions mean that labour will remain relatively immobile.)

As a result, in the long term there could well be natural market pressure towards similar rates of business taxation. This is not the eurosceptics' caricature of EU-enforced 'harmonisation' of taxation rates. No member-state will have to do anything it does not want to do. Indeed, in an expanded Union, the chances of reaching consensus on contentious subjects will be much reduced. What will change is that countries with higher business tax rates (Germany, Italy, France) will begin to see the need to move towards the average, in the interests of their economies. And, as we have seen in chapter 3, that can be done without necessarily increasing labour taxation or cutting public spending.

There is no need to alter business tax rates now, and there is no need to try and be ahead of the game by harmonising before market conditions require it. But neither should policy-makers fear the consequences of the single market. A stronger competitive environment leads to healthier companies, better able to withstand unexpected events and to continue generating tax revenues for governments to spend on their own political priorities. Healthier companies will also lead to greater job stability and higher standards of living. Europe should not harmonise taxes for the sake of it, but should look to harmonise the rules of the game—and that may of itself produce a natural convergence of rates over the long term. The EU's role remains the same as it always has been in this area: to create the conditions to allow the member-states to realise the economic gains of the single market. We should look forward to the opportunities that the single currency presents and plan effectively to reap the maximum reward.

7 Summary of conclusions and recommendations

- ★ There are good economic reasons for harmonising indirect tax rates, both for excise duties and value-added tax. To do so would not only boost the single market but also reduce the incentive to engage in cross-border smuggling (Chapters 2 and 4).

- ★ There are no reasons why income tax should be harmonised across the EU. There is some case on single-market grounds for the harmonisation of business taxation, for companies that are mobile across borders, but the European Commission has no power to take action without the unanimous approval of EU governments (Chapter 2).

- ★ The European Commission should initiate legislation to harmonise the rules of tax accounting, on single-market grounds. At the very least it should be made possible for a company to choose to operate under the same accountancy rules in several EU countries (Chapter 2).

- ★ The EU should make a distinction between the standardisation of accounting systems and any discussion of tax rates, allowing decisions on the former (but not the latter) to take place by qualified majority voting (Chapter 2).

- ★ European governments should strive to reduce tax exemptions that cause the effective rate of taxation to differ from the headline rate. The European Commission, acting as the EU competition authority, should get tough on countries that use tax exemptions as a form of state aid (Chapter 2).

- ★ There is little evidence that greater international competition is eroding revenue to national treasuries. It is therefore hard to explain the rise in taxes on labour as a consequence of business taxes falling.

Similarly, the case for tax harmonisation in order to protect public services appears overstated (Chapter 3).

- ★ There is a single-market case for harmonising levels of tax on mobile financial capital (Chapter 2). The need to prevent individuals evading tax by holding savings abroad is a good reason to introduce a common withholding tax (Chapter 4).

- ★ The original draft directive on the taxation of savings had serious technical flaws; once these are corrected, however, the proposal is unlikely to cause the great damage to Eurobond markets that the City of London fears (Chapter 4).

- ★ Protection of the environment is not a reason for harmonising taxes, although it may be a reason for having higher taxes on polluting activities. As a move towards that end, there is a good environmental case for fixed minimum levels of taxation on polluting activities (Chapter 5).

- ★ The extension of QMV to environmental taxation should be on the agenda of the forthcoming intergovernmental conference—if only to encourage some of the less green member-states to take their environmental commitments more seriously (Chapter 5).

- ★ In the next few years the European Commission should concentrate its efforts on the harmonisation of tax bases, in the interests of the single market, rather than of tax rates (Chapter 6).