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Company Taxation – an Unsolved Issue of EU Policy Making

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Welcome Address

Insufficient Growth in Europe

The European Union is currently facing numerous problems. Focussing on the economic problems alone, let us recall slow growth, high unemployment, and the increasing diversity of Member States since the last enlargement round.

In 2004 the world economy enjoyed its fastest expansion since 1988, growing by 4.2%, with Europe contributing a sluggish rate of a little more than 2% only. For 2005 the world economy is expected to grow by 3.5%, China by 8%, U.S.A. 3.8%, EU-25 will be trailing again with a growth rate of 1.9%. Fortunately the New Member States are growing a few percentage points faster, thus representing one of the growth poles in Europe (the second one are the Scandinavian countries). The unemployment rate in Europe is persistently high at 8%; and even higher in the accession countries (12%). The gap between rich and poor countries is large, New Member States have on average only 60% of per capita GDP of the Old Member States, the incomes in the top regions of the EU are now 4.4 times larger than in those of the poorest 10%.

The Impact of Taxation

The impact of taxes on growth is controversial. Many economists relate the higher growth rate of the U.S.A. relative to Europe to lower tax rates in the U.S.A. But growth in Europe had been higher than in the U.S.A. in the decades before, at a time when also taxes were higher in Europe. Moreover, several high growth countries in Europe have comprehensive welfare systems with high overall tax burdens. While the direct relation between growth and taxes is not easy to establish, there is increasing evidence that the tax structure and the structure of government revenues are important for growth. Taxes can support or slow down economic activity (depending on incentives to work and to invest, to establish new firms, or to relocate business). Government expenditures financed by taxes can support or decrease growth (depending on whether they are spent for education, research or public inputs for firms on the one hand or on consumption or military spending on the other). Overall, there is weak evidence that lower taxes are supportive to growth, but the relation is not robust and clear-cut, and other growth determinants are at least as important.

The Topic of the Workshop

The general topic of the workshop is the future of company taxation in Europe after EU enlargement. This topic is of high relevance for growth and employment, for financing the European model of the welfare state, and for decreasing the income and productivity gap between old and New Member States.

In a certain sense this workshop may be viewed as a follow-up to the international conference on "Tax Competition and Coordination of Tax Policy in the European Union" that was held in Vienna in 1998 under the Austrian EU presidency. Two speakers of that conference are present also today, Professor Bernd Genser from Konstanz, and Professor Sijbren Cnossen from Maastricht.

The issues that will be discussed today, however, have been selected from a more narrow perspective: This workshop will focus on the *taxation of companies*, instead of dealing with the implications of the increasing *European integration for national tax systems* in general, as the 1998 conference did.

What Has Happened on the Positive Side?

A review of the measures implemented since then to coordinate capital taxation in the EU shows that some progress could be achieved in the fight against harmful tax competition: Obviously the European directive on the *effective taxation of interest income* will finally come into effect in the middle of this year. Also the *code of conduct on business taxation*, which aims at the elimination of unfair tax practices distorting fair tax competition, has brought about considerable success in the last few years.

However, one *fundamental debate* is still being led with undiminished intensity among economists: Is tax competition within regular company taxation systems harmful and should it be restricted therefore, or is it to be regarded as beneficial and thus should not be subjected to any constraints: and the positions taken in this dispute seem to be as irreconcilable as ever.

One strand in the literature regards tax competition as efficiency-enhancing, as it prevents Leviathan-governments from exploiting tax-payers and therefore creates a barrier to inefficiently large public sectors. The proponents of capital tax coordination or harmonisation point out potential economically harmful effects of an unbridled tax competition: In particular, they fear an inefficient allocation of capital, the shift of the tax burden to labour or the under-provision of public goods or welfare payments and negative effects on income distribution.

I think it is not biased to say that the majority of economists and politicians favour some limits to tax competition, may it be with the purpose to limit budget deficits, to finance the European model of the welfare state, or to retain money for research, education or infrastructure (investment into the future). The former Austrian Minister of Finance Rudolf Edlinger claimed in his Opening Speech in 1998: “We have invited you to this conference because one of the main issues on the agenda of the Austrian presidency is an increased coordination and harmonisation of tax policies within the EU.” And Mario Monti had added: “Only two years ago, perhaps one year ago, a conference like this would have been just a high-level academic conference. Today, it is an event from which we expect policy-oriented reflections on how to make further progress in implementing a strategy of tax coordination in the European Union that has been clearly set and agreed upon.”

The Changing Environment

Comparing some of the titles of the 1998 conference (e.g. “The Pros and Cons of Tax Competition” or “Perspectives of Capital Taxation”) with the headings of today’s speeches (for example “The Case for Tax Competition”, “The Case for Tax Coordination”, “The Future of Capital Taxation”) suggests that there are still problems and questions in the realm of capital taxation in the European **context** that have not been resolved almost seven years after our first conference.

However, one important element for this debate has changed after the accession of ten New Member States to the European Union in May 2004. The enlargement has increased the complexity of the competition-versus-coordination debate. The old EU Member States by and large can be regarded as a rather homogeneous country club, at least in the meantime. The accession of eight Central and Eastern European countries that are in a different economic situation and have differing institutions and traditions, however, has transformed the EU into an economic area which is characterised by an unprecedented degree of (economic) heterogeneity. This may make it necessary to re-think and to question established knowledge and convictions concerning the coordination and the design of capital taxation in the European Union. Today’s workshop does not only aim at solving the debate on the necessity and the options of capital tax coordination in the EU. It will also put the taxation of capital into a new perspective, that of European enlargement. If we assess the European problems, the different options how to return to a higher growth path, and the conflicting views on the impact of corporate taxation, I am sure that the workshop will become very interesting and stimulating.

The workshop is jointly organised by the Oesterreichische Nationalbank (OeNB), the University of Vienna, and the Austrian Institute of Economic Research. Since I will not be able to attend all sessions and specifically not the last one I may take the opportunity to thank the organisers and particularly Margit Schratzenstaller from the Austrian Institute of Economic Research, Walpurga Köhler-Töglhofer from the OeNB, and Andreas Wagener from the University of Vienna for their work. We are also grateful to the OeNB for hosting and co-financing the workshop. And last but not least I would like to thank all speakers and discussants; some of them travelled long distances to participate in today's workshop.