# Which Way to Converge? The Europeanisation of National Tax Systems

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Abstract: In this article we investigate in how far European Integration stimulates policy convergence in various subfields of tax policy. We see that several causal mechanisms contribute to an EU-wide convergence of tax policies: imposition, competition, harmonization and learning/ communication. Whereas personal income taxation does not exhibit strong EU-specific reasons for policy convergence, corporate income taxation is spurred by deeper market integration and imposition through the ECJ. More importantly, EU harmonization and (strategic forms) of learning within EU member states have had a direct and noticeable impact on national systems of VAT and excise taxation.

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## Introduction: Europeanisation and Convergence of National Tax Policies

From their very beginning the European Communities have faced the suspicion that they accelerate the convergence of national tax policies either by enhancing competition or direct harmonization. Recent research has rekindled this suspicion for some areas of taxation. Although the overall effect is still limited, the compound effect of EU institutions has accelerated, for instance, the competition on corporate income (Genschel, et al., 2008). And yet it is also clear that competition is not the only way how EU institutions shape national tax systems. In some respect it may not even be a major way.

To name but a few examples: the EU acquis communautaire indirectly transforms national income taxation guaranteeing stable investment conditions abroad; the EU adopts legislation to harmonize the system of European consumption taxes; the European Court of Justice (ECJ) produces case law that reaches deeply into the sovereignty of national tax policy makers; EU soft law spurs processes of learning and of shaming harmful tax practices (Kemmerling and Seils, 2009 fc; Radaelli and Kraemer, 2008). These examples show that the EU disposes of a full battery of different measures to shape national tax systems and to increase their convergence.

Hence, we should expect the EU to have a noticeable impact on national tax systems. This hypothesis squares with two contradictory facts: First, the EU has no direct competences in taxation itself. Taxation is still a national domain, and decisions on tax issues are still subject to the unanimity rule of voting in the Council. It is therefore no wonder that in terms of primary legislation, taxation is one of the least dynamic areas. Second, we do not see much policy convergence on the aggregate level of tax ratios the size of the tax state (Garrett, 1998; Genschel, 2002a).

To see how the EU affects national tax policies one has to disaggregate total taxation into specific areas of taxation, in which EU policy makers directly intervene. For that purpose we look more deeply into direct taxes (corporate and personal income) and indirect taxes (general consumption taxes and excises). We also use several different indicators of taxation (rates, ratios and qualitative properties). This disaggregation gives us a more fine-grained, nuanced picture of how the EU affects national tax systems. In fact, we find evidence for all major mechanisms at work, in times even in interaction with each other. We see that the EU gives national tax systems in member states a momentum of its own with important normative and analytic consequences. We also see how a study of the EU and national tax systems enriches our understanding of the processes of international policy convergence in- and outside of the EU.

This paper starts with a brief and selective overview of the literature on international policy convergence. We will revisit some of the prime suspects of causing these processes. The next section reports on EU activities in the four fields of taxation. We will derive some hypotheses about whether and how to see some empirical evidence for these mechanisms of convergence. The following section presents the empirics of international policy convergence for the four fields. We compare the evolutions of tax indicators of core EU countries with selected non-EU OECD countries and judge in how far the available evidence is consistent with different causal mechanisms of policy convergence. The final section draws comparisons between the four fields and concludes.

## Causal Mechanisms of International Policy Convergence

In recent years there has been a remarkable renaissance in studies about international policy convergence (Holzinger and Knill, 2005; Meseguer, 2005; Simmons, et al., 2006 (i.E.)). Compared to older contributions (Collier and Messick, 1975) the biggest difference of the new literature lies in the large variety of theoretical explanations and approaches. Holzinger and Knill (2005), for instance, focus on the following four (groups of) causal mechanisms: imposition, harmonization, competition, and transnational communication. They also mention a fifth one which is parallel problem pressure. Since parallel problem pressure does not require countries to interact in any meaningful way, but relies on similar conditions of domestic politics, we can skip it and explain the four international mechanisms in some more detail.

The paradigmatic case of imposition is when the IMF or the World Bank gives a conditional loan to countries on condition of their compliance with some established rules (Meseguer, 2006). Coercion and the exercise of political power are of defining importance for this mechanism (Dolowitz and Marsh, 1996). Delegation of legal powers and the judicialization of policy fields can endow international organization with enough authoritative power to impose and sanction nation states behaviour (Zangl, 2005). If this authoritative power is used to impose similar decisions and rulings on many or all states, the result is an overall convergence of policies.

International harmonization may also rest on the existence of internationally binding norms and of international institutions that monitor their implementation. However, harmonization always presupposes some degree of (voluntary) cooperation between nation states. Countries must have had, at least, at some point in the past, agreed to submit to such arrangements. Compared to imposition harmonization and, more generally, international cooperation should be interpreted not as hierarchical, but as horizontally negotiated adjustments in national policies (Dolowitz and Marsh, 1996).

By contrast, regulatory competition stems from the absence of international cooperation or any hierarchical forms of imposition. Countries are expected to converge because of the strategic incentives to over- or underbid other countries policies. In strong notions of regulatory competition, this may lead to a race to the bottom in legal standards (Sinn, 2001), but there are also examples of jurisdictional competition which lead to a race to the top (Vogel, 1995). Regulatory competition can take many forms. If, for instance, voters have imperfect knowledge about good policies they may use policy levels of other countries as a source of information. This leads to so-called yardstick competition between countries (Besley and Case, 1995).

Moreover, not all countries may face similar strategic incentives. In the realm of tax policy, for instance, it has been argued that only small countries have a genuine incentive to cut tax rates, since the revenue losses in their national tax base are marginal compared to the inflows of foreign tax base (Kanbur and Keen, 2001). It has also been argued that countries with stronger financial sectors have an additional incentive to attract foreign capital (Holzinger, 2005). If this any of these arguments is true one should not expect an absolute convergence of tax rates, but rather a conditional convergence for groups of countries of similar size or with similar financial sectors (Ganghof, 2006b).

The last category, transnational communication, accommodates many different mechanisms such as naïve emulation of other policies or different versions of policy learning (Hall, 1993; Radaelli, 2000). Countries may emulate each other out as a consequence of 'collective herd behaviour' and global intellectual trends. They may use other countries performance to judge the efficacy of policies and adopt successful policies and abolish policy failures (Meseguer, 2006). In this case countries not only learn from their own experience, but also from the experiences of other countries (Volden, et al., 2008). Other versions of this causal mechanism focus on the role of ephistemic communities and transnational problem solving which goes beyond bilateral learning exercises (Haas, 1992).

Applying these different mechanisms to specific research questions is not always straightforward, however. Whereas research on international policy diffusion directly tries to test different mechanisms, research on international policy convergence tends to focus on substantive outcomes such as the speed, direction or significance of divergence and convergence. In these cases international causes of convergence may be overrated in relation to domestic causes (Kemmerling, 2008; Volden, et al., 2008). Moreover, the boundaries of the four mechanisms are blurred. A lot of learning is done strategically along the lines of competitive pressures and harmonization can be frozen into imposition.

Finally, some of these causal claims yield very similar empirical observations on an aggregate level of cross country comparisons. For instance, it is empirically very difficult to distinguish voluntary from coercive agreement since the notion of power is a very malleable (cf. Kemmerling 2007). Bearing these caveats in mind, the four mechanisms are still important means to understand the role of the European Union (EU) in the determination of national tax policies.

## How the EU affects the convergence of national tax policies

EU scholars have used varieties of the four causal mechanisms to explain the integration or convergence of various policies fields in the EU. First, the impact and limits of legal imposition on nation states is a widely studied topic (Boerzel, 2006). The 'disciplinary function' of membership in the European Monetary Union (EMU) has been observed for fiscal and income policies in the EU (Enderlein, 2006). Second, coordination and harmonization can be observed in most areas of (product market) regulation (Scharpf, 1999). Third, various authors argue that economic competition is now the driving force for EU policy making and has deep repercussions on the national level (but cf. Majone, 2005). Fourth, recent initiatives by EU institutions have created a cottage industry of investigation for new modes of governance. In particular EU soft law and the open method of coordination are supposed to facilitate cross-national learning and convergence (De La Porte and Nanz, 2004). Learning has been singled out as one of the key reasons for EU-wide policy transfer and convergence (Radaelli, 2005). Taken together, these findings show two things: first, the EU has been related to many different causal mechanisms of policy convergence; second, causal mechanisms may differ across policy areas. Hence, the next step in the analysis is to apply this general literature to the relationship between the institutions of the EU and the national tax systems of its member states.

In general, the EU impact on tax policy convergence seems to be fairly limited. There is no evidence for an absolute convergence of tax levels in the EU or the OECD (Seils, 2007). Tax policy has remained one of the few policy areas which have remained under the control of national jurisdiction and the direct impact seems of the EU on national tax policy making seems to be severely limited by the principle of unanimity and the small size of the EU budget. However, it is easy to show that the EU has continuously expanded its influence on national tax policies by a battery of indirect and direct measures.

Some of the activities of the EU which were not designed to affect tax policies can have a dramatic impact on national tax policy making. A complete list of these **indirect** activities is beyond the scope of this paper, but some important examples suffice to show this. First, EU market integration has powerful spillover effects to national tax systems. The abolition of national regulatory arbitrage accelerates the flow of goods and services. This affects national tax bases of consumption and labor taxes, as well as the structure of the tax system. Second, the integration of capital markets and the adoption of a common currency strongly accelerate capital flows within the EU. This has direct implications for

the national systems of income taxation. Third, the adoption of the acquis communautaire by new member states guarantees stable political and economic institutions such as property rights and access to legal systems. Together with stable or predictable exchange rates this greatly reduces risks to invest abroad. This makes flows of capital between member states much easier with all implications this has on the national system of capital taxation.

Despite the high legal thresholds for direct action on the intergovernmental level, EU institutions have been remarkably active in the field of tax policies. Table 1 gives evidence for the three types of **direct** activities of the Commission, the Council and the European Court of Justice (ECJ): (1) ‘information’ contains activities such as recommendations, opinions and resolution, but also important communications and influential reports. These measures have in common that they are not legally binding, but that they provide important focal points for cooperative efforts and subsequent rounds of negotiations on legally binding initiatives, (2) ‘legislation’ contains all activities with legally binding character, in particular directives and regulations; (3) ‘jurisprudence’ contains court rulings with a direct impact on national tax policies.

Beginning with the first category, information, one sees an obvious explosion of activities in the area of tax policies in recent decades. More importantly, there is an obvious shift from information exchange on excise taxation in the beginning to VAT in the 1970s and CIT in recent years. Most information exchange takes place in the form of reports and recommendations of the Commission to other organs of the EU such as the Council or the Parliament. [Legislation] Legislative acts consist of decisions, regulations and directives in the field of tax policy. With some 60 percent of all legal acts, decisions are by far the most common form. The overwhelming part of legal acts deals with indirect taxation, and only in recent years there have been a few, but noticeable legal activities in corporate and personal income taxation. [Jurisprudence] Activities of the ECJ primarily consist of preliminary rulings, and to a lesser extent, of infringement procedures. Again, most activities are found in the realm of indirect taxation, but in recent years, more and more cases of direct taxation are brought to the court. In comparative terms, direct taxation seems to be driven by court rulings and informative activities of the EU, whereas legislation has also a substantive quantitative dimension in indirect taxation.

The stocktaking of EU activities in the field of tax policies has demonstrated that EU disposes of a large and increasing variety of ways how to influence national tax policies. The variety of measures could imply that the EU sends signals on all channels of causal mechanisms for tax policy convergence: Court rulings are an important source of international imposition, legislative procedures lead to harmonization in national tax policies, information activities speed up learning processes, and many indirect measures enhance competitive pressures. But the question remains whether these signals are strong enough to affect national tax policies and to lead to their EU-wide convergence. In the next section we analyze the evidence for this impact on the four major fields of tax policy: personal and corporate income taxation, general and specific consumption taxation.

## Evidence on Tax Policy Convergence: EU vs. OECD

Since there is little reason to expect evidence for absolute policy convergence in the size of the tax state one has to dig a little deeper into the tax structure and composition of taxation to find out about convergence effects and the role the EU plays in the field of tax policies. For that purpose we need to distinguish between different forms of taxation and different tax indicators. We focus on the major tax forms only, i.e. corporate (CIT) and personal (PIT) income taxation for direct taxes, and general consumption taxes (usually VAT) and excises as the major indirect taxes. We also distinguish between different indicators to account for the fact that different causal mechanisms may hit at different aspects of the tax system. Therefore, we track the temporal evolution and convergence of three different indicators: nominal tax rates, tax-to-GDP ratios and qualitative indicators of the tax system. We will track changes of these indicators across time for the last 30 years. To sort out effects of Europeanisation from general effects of globalization (Verdier and Breen, 2001) we distinguish between long-standing EU members (EU-10)[1] and OECD countries that have never become a member states (OECD-11)[2].

In the literature on international convergence (Holzinger and Knill, 2005; Quah, 1996) knows different measures of convergence. In this part of the paper we will largely focus on three different measures. First, standard deviations and the coefficients of variation are measures of sigma convergence, i.e. an increase of likeliness over time. Second, we will be careful to specify whether we need to focus on absolute or conditional convergence. Since determinants leading to conditional convergence depend on the field of tax policy and the causal mechanism we will rely on evidence of other studies. Third, the upward or downward direction of the convergence can yield important insights in the causes of convergence. For instance, competitive pressures should – in the long run – lead to a downward trend in the taxation of mobile tax bases, whereas harmonization or learning could also lead to upward trends.

### *Corporate Income Taxation*

Let us begin with two major trends in the taxation of corporate income that are not related to the EU. First, corporate income taxation is an area in which global competition should matter. The tax base of incorporated firms is mobile, its key agents, multinational firms, are versatile optimizers of international tax arbitrage (Devereux, et al., 2008; Ganghof, 2000; Slemrod, 2004). Second, corporate income tax is also subject to major intellectual and ideological trends that are not necessarily constrained to the EU (Swank, 2006). An example is the trend in OECD countries towards cutting rates and broadening the tax base (Loretz, 2008). Given this evidence for policy (conditional) convergence in the OECD world, we would expect that the EU reinforces, reshapes or accelerates the ongoing globalization of corporate taxation (Genschel, et al., 2008).

[1] EU-10 countries are Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands and United Kingdom.
[2] OECD-11 countries are Australia, Canada, Iceland, Japan, Korea, Mexico, New Zealand, Norway, Switzerland, Turkey and United States of America.

The EU treaty provides little guidance in the field of income taxation (Cnossen, 2001), since it mentions income taxes only in as far as they interfere with the goal of a functioning single market. The EU history is full of failed initiatives to coordinate or even harmonize tax rates and tax bases. As early as 1962 the Commission experimented with the idea of a harmonization of the effective tax burden (Neumark Bericht, 1962) and drafted several times (e.g. 1967, 1975) directives in that direction (Genschel, 2002b). In the 1990s the Commission reinitiated its efforts and endorsed a common minimum tax rate, which, so far, has not materialized, given the objections of some member states.

And yet, the EU was not without influence. On the one hand, it achieved some cooperation on preferential tax regimes and 'harmful tax practices' (Radaelli and Kraemer, 2008). On the other hand, it paved the way for capital to harvest the gains from tax arbitrage (Cnossen, 2001): It made cross-border movements of firms easier through a number of directives such as the parent–subsidiary directive (Directive 90/435/EEC) or the merger directive (Directive 90/434/EEC). In addition, a battery of influential court rulings strengthened the position of multinational firms and weakened member states' attempts to unilaterally defend their eroding corporate tax base (Genschel, et al., 2008). Moreover, as expected the reduction of investment risks spurred transnational movements of capital dramatically (Cnossen, 2001).

All things considered, we should expect a clear impact of the EU on national systems of corporate taxation. What does the data say? Table 2 shows some indicators for corporate income taxes in OECD countries. Beginning with nominal tax rates one can see that the mean for all countries has dramatically declined. The standard deviations and the coefficients of variation increase for both EU-10 and for OECD-11. Contrary to rates, ratios have increased in all countries. This implies that corporate taxation has followed the general trend of a rate cut with a base broadening that more than compensated the losses in revenues. Standard deviations, however, speak for some bifurcation between the ratios for the EU and for the rest of the OECD countries: whereas it decreases for the EU-10, it increases for OECD-11 countries. Hence, there is some weak evidence for an additional impact of the EU on absolute convergence in corporate tax rates and ratios. This evidence is stronger for the case of conditional convergence. For instance, country size is a stronger predictor for the height of tax rates within the EU than in the rest of the world (Genschel, et al., 2008). It is hence true that within the EU small states face especially high incentives to underbid other countries' tax rates.

The table also contains information on a very important structural characteristic of the corporate taxation, namely the way how dividends are treated (Graetz and Warren, 2007). Dividends are haunted by two types of double-taxation problems: first dividends may be taxed at the levels of firms and stock owners; second dividends of foreign stock owners may be taxed either in country of the firm or the stock owner. Hence corporation taxes are commonly differentiated on how they use dividend relief. The so-called classic system does not provide any relief, whereas, imputation systems give shareholders a tax credit against their personal income tax. Apart from these two major systems there are also other techniques such as taxing dividend income with a separate (scheduler) PT rate.

Under the imputation system it is difficult to treat foreign and domestic shareholders equally. This discrimination has led the ECJ to substantively prohibit the imputation system within the EU (Graetz and Warren, 2007). Table 2 shows that between 1981 and 2006 EU countries switched to (modified) classic systems or new hybrid forms, whereas imputation systems have become the typical form of dividend treatment in the OECD-11. In fact, none of the EU members except for the UK operated in 2006 an imputation system any more. Even the British imputation system has had to be adjusted due to interventions of the ECJ.[3] This is a clear indication that imposition by judgments of the ECJ has a visible effect on the convergence of structural characteristics of tax systems in Europe.

***Personal Income Tax***

With dividend taxation we have already entered the area of overlap between corporate and personal income taxation. Personal income taxation is very complex since people may have very diverse forms of income. Two major classes of income are capital and labor. Whereas capital income is closely related to corporate income and, in fact, in many instances even more mobile, labor income, i.e. wages, is less mobile. Due to these differences countries are left with several trade-offs, in particular between treating capital and labor taxation equally, reacting to the mobility of personal capital income, and maintaining progressivity of the income tax system (Ganghof, 2006a). For that reason countries have chosen different paths ranging from a flat tax treating all forms of income equally (e.g. Slovakia) to a dual or schedular income tax (Sweden). Again there are several arguments why countries have chosen these paths, but overall there is little convergence visible towards either of the extremes. To the contrary, domestic politics seems to be a major driving force that shapes tax policies in income taxation (Steinmo, 1993).

As seen above, the EU has undertaken few direct steps at harmonizing income taxes. However, in as much national legislation interferes with the four freedoms and the single market, income taxation is nowadays indirectly controlled by the EU. The clearest example is rulings by the ECJ (Genschel, et al., 2008). Moreover, much of the stimulus of EU initiatives comes from the fact that interest income and dividend income, and thereby, corporate and personal income taxation, are tightly linked in an integrated economy. The EU has exacerbated the situation, since the abolition of interest rates and exchange rates in the monetary union have left tax arbitrage as the only meaningful form of arbitrage for interest income (Schratzenstaller, 2003). It is therefore no wonder that the incidence of tax evasion and avoidance in this area is particularly high, especially in Europe, and that countries which tried to implement or increase new taxes on savings faced severe losses in public revenues (Dehejia and Genschel, 1998). This has prompted the EU to undertake several initiatives to coordinate the taxation of interest income. Most prominently, the Council adopted the savings directive in 2004 which phases in a system of two options for member states: they can either choose to exchange information on interest income or they can charge a minimum withholding tax at the source of the income (Holzinger,

[3] Compare ECJ cases C-397/98 and 410/98 on Metallgesellschaft, Hoechst et al. of the year 2001.

2005). It remains to be seen whether this cooperation will effectively confront some of the collective action problems in international savings taxation, but the savings directive has so far been the most ambitious effort to harmonize part of national income taxation on the European level.

What does the data say? Table 3 shows rates, ratios and structural indicators for personal income taxes in OECD countries. Looking at the nominal top marginal income tax rates one can see that they have fallen in the last 25 years in all countries. In this respect countries have also become more and more alike as the standard deviations show, although the convergence seems to be much stronger in the OECD-11. Similar to corporate income taxation, the fall of personal tax rates has not automatically led to a decrease in revenues. In EU countries ratios have increased somewhat, whereas in the rest of the OECD countries they have slightly fallen. Absolute convergence measured as falling standard deviations or coefficients of variation is higher in the other OECD countries than within core EU countries.

The number of tax brackets also shows a uniform downward trend in both EU-10 and OECD-11 countries. Therefore the cut in nominal tax progressivity and tax complexity seems to be due to global rather than to EU-specific reasons. There is still a debate as to why tax progressivity has been on decline in recent years. Some authors argue that this is a direct consequence of global tax competition (Genschel, 2002a), whereas others would argue that it is due to efficiency considerations of the government (Swank, 2006) or domestic politics (Kemmerling, 2009). Either way, neither rates nor ratios speak for EU-induced policy convergence.

What we do see, however, is that even before the savings directive, EU countries converged in their withholding taxes of interest income.[4] In the 17 years between 1985 and 2002 withholding taxes increased both in EU-10 and OECD-11 countries, but they have become slightly more similar in the EU-10, whereas no such convergence is visible in the OECD-11. Anecdotal evidence suggests that the EU and, in particular, the abolition of capital controls, made national deviations prohibitively costly and policy experiments have had to be coordinated across EU countries.

### *General Consumption Taxes*

Let us again start with forces that shape general consumption taxes and are not necessarily related to the EU. Value-added taxes (VAT) are arguably the most important tax innovation of the 20$^{th}$ century. Once VAT was introduced the bulk of consumption taxes was shifted from excises to the general taxation of all forms of consumption (Cnossen, 1998). VAT has even become the single most important source of revenues in 9 out of 30 OECD countries (Kemmerling, 2009). The spread of VAT has provoked a lot

[4] It has to be mentioned that national systems of savings taxation are very complex so that these country means are very delicate. We only used data on the taxation of bonds and only for clear cases of withholding taxes at the source of income.

of scholarly interest. Some argue that in recent years VAT has been the only stable means to finance an expanding welfare state without compromising international competitiveness (Beramendi and Rueda, 2007; Kato, 2003). Most economists argue that the success of VAT stems from its efficiency, since it has a broad base and only distorts people's decision to consume, but nothing else. There are also two truly international factors that may have lead to international policy convergence. First, the success of VAT may be the result of international policy diffusion and, in particular, policy learning (Kato, 2003). Second, competitive pressures may play a role in the spread of VAT, above all, if the principle of origin rules that VAT is paid in the country from which the product originates. Although consumption is not as mobile as flows of capital, tax competition still happens, e.g. induced by cross-border shopping and tax evasion (Kanbur and Keen, 2001).

Contrary to direct taxation, the EU has always been a key driving force of general and specific consumption taxes. Article 99 of the old EU treaty explicitly requires the harmonization of sales taxes and excises. From its very beginning the EU hence faced two problems with general consumption taxes: first, how to assure that domestic and imported products are taxed in a non-discriminatory way; second how to assure that tax revenues are distributed fairly across countries (Genschel, 2007). The introduction of VAT proposed a solution to both problems, albeit a partial one. In 1967 Member states agreed on the conversion of sales taxes to VAT, but only ten years later the EU passed the $6^{th}$ VAT directive that adopted the destination principle to govern cross-border flows of goods and services. The directive also defined a minimum standard rate of 15 per cent and the use of reduced and maximum rates for certain products.

A look at Table 4 shows the evolution of VAT indicators. The nominal standard rate has, on average, increased in both EU and none-EU countries. The standard deviation is on the rise in the OECD-11 and in EU-10 countries. Interestingly, although the EU tries to diminish of the use of reduced rates it has not been very successful so far. Old member states were allowed to maintain their exceptions and new member states also negotiated for reduced rates. These exemptions were codified in EU VAT directive of 1992. The EU was successful however, to help curtail the use of super-rates for luxury and other goods which were some times as high as 110 per cent in Portugal. VAT ratios broadly move along the lines of VAT rates. This reflects the proportional character of VAT with few exemptions in the tax base only (Kemmerling 2009). And yet, as the standard deviations show, both groups EU-10 and OECD-11 countries diverge in their capacity to convert VAT rates into revenues.

As for the timing of the introduction, the EU clearly differs from the rest of the OECD. EU-10 countries adopted VAT around 1972, whereas the rest of the OECD needed almost 15 years more, and in the case of the US, has never introduced it so far. This shows how decisive the influence of EU harmonization has been on national systems of general consumption taxes. However, it is also true that the motives for complying with Europe different greatly from country to country. Whereas Germany and France wanted to solve the problems of cross-border consumption and revenue generation, the UK embraced VAT as a substitute to inefficient and unpopular taxes such as the selective

employment tax (Kemmerling 2009). One may conclude that VAT may still be the dominant form of general consumption tax in Europe even without the EU, but the EU endorsement speeded up its diffusion and partial convergence considerably.

### *Specific Consumption Taxes*

The most important form of specific consumption taxes are excises. Excises have a long history, but in the 20th century their importance is on relative decline. Yet some excises, namely those on alcohol, tobacco and fuel are still important sources of public revenue. Moreover, they also have an important regulatory function in addition to revenue collection. Since excises come in many different forms and with many different purposes, the first potential cause for convergence or divergence lies in domestic politics. Specific consumption patterns differ widely across countries not least due to differences in cultural habits of drinking, smoking or driving (e.g. Cnossen 2007). For all these reasons it is obvious that national trajectories in excise taxation have been very different and that national policy makers 'cherish' their cultural peculiarities. If there are any common global trends in excise taxation they must be due to either technical innovations such as eco-taxation or competitive pressures. Indeed Egger et al. (2005) find some evidence for strategic interaction, i.e. international competition, in the realm of commodity taxation. And yet, this competition will be clearly limited if compared to competition on corporate and private capital income.

Competition and harmonization may matter much more within the EU. The harmonization of excises belongs to the mandate of the European Union. In the wake of the Single Market of 1993, the EU passed important directives such as 02/84/EEC which replaced the old duty-free regime by a comparatively lenient system of regulating cross-border shopping (Lockwood and Migali, 2008). Moreover the directive implemented minimum excise duties on alcohol and tobacco and ruled that the standard VAT rate had to be applied to these goods. Similar things apply to fuel taxation. Imposition by court rulings also plays a role. The ECJ has made a number of influential decisions especially against the discriminatory taxation of domestic and foreign products containing alcohol (Cnossen, 2007).

Table 5 shows some indicators for excises taxes across time. Columns 2 and 3 of Table 5 show the ratio of tax revenues from all excises to GDP (OECD revenue statistics, category 5120). For the OECD-11 one can see a decline in the ratios across time, but an increase in the standard deviation. For the EU-10 both the mean and the standard deviation decreases and suggests a modicum level of absolute convergence.

Since there are so many forms of excises we have deliberately chosen rates for diesel taxes only. Beginning with these rates we see that diesel tax rates (in constant USD per liter) went up. More importantly, the standard deviations for EU-10 went down whereas OECD-11 countries diverge in their practice of taxing diesel. For the specific case of diesel taxation, Evers et al. (2004) find that harmonization has lead to some upward convergence, but that competition within the EU remains strong. If there is conditional

convergence it is between high and low tax countries. For excises on alcohol and cigarettes Lockwood and Migali (2008) find competition effects after the introduction of the single market in 1993. They conclude that economic competition on excises has significantly increased because of the deepening of European integration. They also find descriptive evidence for an upward convergence for alcohohl and cigarette taxation in EU countries.

However, it has to be noted that there is a marked upward trend in fuel, alcohol and cigarettes taxes which is somewhat at odds with naive predictions of strategic competition. Econometric studies do find country-level contagion, but why do these countries convergence in rising and not falling tax rates? Prima facie it is not unlikely that EU countries also learned from each other in the sense that politicians found it is easier to raise taxes on commodities that are heavily taxed in neighboring countries.

## Comparative Evaluations

Table 6 summarizes our major findings comparing both the EU-10 and the OECD-11 group. The blue-shaded cells show cases in which the EU and the OECD trends go into different directions. We see convergence of CIT ratios for EU-10 exclusively, whereas we see a convergence of PIT ratios for OECD-11 exclusively. Top PIT rates have declined and converged in all countries uniformly. VAT rates and ratios have neither converged in the EU-10 nor in the OECD-11. In the case of Diesel taxation we see no evidence for convergence, but we see that general ratios have converged somewhat in EU-10, but not in OECD-11. As for the qualitative indicators we see a more direct impact of EU institutions. For instance, ECJ judgments have ruled out the imputation system the treatment of dividend taxation. Tax competition has had an impact on withholding taxes in the EU-10, but not elsewhere whereas EU harmonization has speeded up the introduction of VAT and the restrictions put on excise taxes.

As for the causes of these commonalities and differences in convergence we can only give premature answers with such a descriptive exercise. However, a few findings merit repetition. First, in the field of corporate taxation the primary mode of policy convergence is deregulatory competition. The EU seems to contribute an add-on effect on the otherwise global competition on corporate capital. Specifically, the EU exerts the effect of ECJ-driven imposition on the (de-)regulation of corporate income taxation. Second, in the field of personal income taxation the case of international policy convergence is clearly limited. There is some evidence for the structure of income taxation, namely the downward trend in progressivity, but this is primarily due to world-wide (intellectual) trends and also domestic constellations (Kemmerling, 2009). The EU still seems to have a limited, but possibly increasing impact in this field. Third, for specific and general consumption taxes, the impact is much more visible. In both cases convergence is stronger within the EU than in other OECD countries. Harmonization has effectively changed national tax systems considerably. Though competition effects are not to be neglected, the available evidence is more in line with (strategic) learning and

yardstick competition. Policy makers use foreign experience to legitimize increases in public revenues. This is consistent with the overall upward trend in VAT (rates and ratios) and specific excise rates. For a closer test of these hypotheses one would need to switch from a convergence to a diffusion perspective. This is beyond the scope of this paper, but a stimulating field of research for follow-ups.

**Table 1 Secondary tax legislation and tax jurisprudence in the EU**

| | **Information** | | **Legislation** | | **Jurisprudence** | |
|---|---|---|---|---|---|---|
| | 58-80 | 81-07 | 58-77 | 78-07 | 58-77 | 78-07 |
| **by tax area** | | | | | | |
| VAT | 6 | 84 | 8.5 | 197.5 | 18 | 357.5 |
| Excise and other indirect tax | 14 | 28 | 7.5 | 110.5 | 21 | 219.5 |
| Corporate tax | 3 | 27 | 0 | 5 | 1 | 56.5 |
| Personal tax | 3 | 15 | 0 | 11 | 3 | 68.5 |
| Administrative Cooperation and miscellaneous tax | 8 | 17 | 6 | 36 | 0 | 12 |
| **by legal subject** | | | | | | |
| Primary law | n.a. | n.a | n.a. | n.a | 33 | 248.5 |
| Secondary law | n.a. | n.a | n.a. | n.a | 10 | 465.5 |
| **by issuing institution** | | | | | | |
| Council | 5 | 0 | 22 | 329 | n.a. | n.a. |
| Commission | 18 | 140 | 0 | 31 | n.a. | n.a. |
| **Total** | **30** | **134** | **22** | **360** | **43** | **714** |

Sources and notes:
Information contains recommendations, resolutions, communications, opinions and selected reports of the Council and the Commission. For earlier years data comes from own research in the archives of the Council and the Commission. For later years we also used information from prelex and eurlex databases and information from DG TAXUD.
Legislation contains directives, regulations and decisions (Source: Genschel, et al., 2008).
Jurisprudence contains rulings of the ECJ (Source: Genschel, et al., 2008).

**Table 2 Corporate Tax Rates, Ratios and Systems in 1981 and 2006**

| | Nominal Rate | | Ratio | | System | |
|---|---|---|---|---|---|---|
| | 1981 | 2006 | 1981 | 2006 | 1981 | 2006 |
| **EU-10** | | | | | | |
| Mean/ Mode | 47.09 | 29.98 | 2.33 | 3.59 | I | C,O |
| Std. Dev. | 6.14 | 6.60 | 1.26 | 0.73 | | |
| Coeff. Var. | 0.13 | 0.22 | 0.54 | 0.20 | | |
| **OECD-11** | | | | | | |
| Mean/ Mode | 45.48 | 29.25 | 3.20 | 4.78 | O | I |
| Std. Dev. | 6.50 | 7.40 | 1.86 | 3.24 | | |
| Coeff. Var. | 0.14 | 0.25 | 0.58 | 0.68 | | |

Note: own calculations on basis of OECD tax database.

**Table 3 Indicators of Personal Income taxation for 1981 and 2006**

| | Top Nominal Rate | | Ratio | | No. of Brackets | | Withholding Tax | |
|---|---|---|---|---|---|---|---|---|
| | 1981 | 2006 | 1981 | 2006 | 1981 | 2006 | 1985 | 2002 |
| **EU-10** | | | | | | | | |
| Mean | 64.16 | 46.19 | 10.42 | 10.86 | 13.38 | 4.56 | 13.75 | 16.90 |
| Std. Dev. | 7.36 | 6.39 | 5.14 | 5.20 | 9.41 | 2.36 | 13.19 | 10.85 |
| Coef. Var. | 0.11 | 0.14 | 0.49 | 0.48 | 0.70 | 0.52 | 0.96 | 0.64 |
| **OECD-11** | | | | | | | | |
| Mean | 69.12 | 44.65 | 10.28 | 9.05 | 11.71 | 4.00 | 13.75 | 18.33 |
| Std. Dev. | 17.86 | 4.40 | 4.92 | 3.97 | 8.12 | 1.33 | 17.02 | 17.56 |
| Coef. Var. | 0.26 | 0.10 | 0.48 | 0.44 | 0.69 | 0.33 | 1.24 | 0.96 |

Note: own calculations on basis of OECD tax database and (BMF, 1985; Schratzenstaller, 2003) for withholding taxes.

**Table 4 Standard and Reduced VAT Rates, Ratios and Year of Introduction**

| | Nominal Rate | | Reduced Rates | | Ratio | | Year of Introduction |
|---|---|---|---|---|---|---|---|
| | 1980 | 2006 | 1980 | 2006 | 1980 | 2006 | |
| **EU-10** | | | | | | | |
| Mean | 16.84 | 19.31 | 4.81 | 4.71 | 5.88 | 6.44 | 1971.80 |
| Std. Dev. | 4.27 | 2.68 | 2.89 | 1.45 | 1.97 | 2.61 | 5.46 |
| Coeff. Var. | 0.25 | 0.14 | 0.60 | 0.31 | 0.34 | 0.41 | |
| **OECD-11** | | | | | | | |
| Mean | 13.33 | 13.46 | 5.00 | 3.67 | 3.36 | 5.15 | 1986.20 |
| Std. Dev. | 5.77 | 7.08 | 0.00 | 3.79 | 1.96 | 2.40 | 8.78 |
| Coeff. Var. | 0.43 | 0.53 | 0.00 | 1.03 | 0.58 | 0.47 | |

Notes: own calculations on basis of OECD tax database.

**Table 5 Ratios for all Excise Taxes and Rates on Diesel taxation**

| | Ratio 81 | Ratio 06 | Diesel tax rate 80 | Diesel tax rate 05 |
|---|---|---|---|---|
| **EU-10** | | | | |
| Mean | 4.49 | 3.79 | 0.12 | 0.49 |
| Std. Dev. | 1.86 | 0.61 | 0.09 | 0.15 |
| Coeff. Var. | 0.41 | 0.16 | 0.72 | 0.30 |
| **OECD-11** | | | | |
| Mean | 4.73 | 3.74 | 0.03 | 0.33 |
| Std. Dev. | 1.58 | 2.28 | 0.05 | 0.31 |
| Coeff. Var. | 0.33 | 0.61 | 1.72 | 0.93 |

Notes: own calculations on basis of OECD tax database and International Energy Agency

**Table 6: Comparison of Rates and Ratios over time for EU and OECD**

| | | EU-10 | | OECD-11 | |
|---|---|---|---|---|---|
| | | Mean | Std. Dev | Mean | Std. Dev |
| CIT | Rates | ↓ | ↑ | ↓ | ↑ |
| | Ratios | ↑ | ↓ | ↑ | ↑ |
| | Other | Full Imputation dies out | | Full imputation en vogue | |
| *Causal Mechanism* | | *Competition, Imposition* | | *Competition* | |
| PIT | Rates | ↓ | ↓ | ↓ | ↓ |
| | Ratios | ↑ | ↑ | ↓ | ↓ |
| | Other | Less brackets, Rates/Ratio↓ | | Less brackets, Rates/Ratio↓ | |
| *Causal Mechanism* | | *(Competition, Information)* | | *Competition, Information* | |
| VAT | Rates | ↑ | ↑ | ↑ | ↑ |
| | Ratios | ↑ | ↑ | ↑ | ↑ |
| | Other | Early Introduction | | Later Introduction | |
| *Causal Mechanism* | | *Harmonization, Learning* | | *(Learning)* | |
| Other ind. | Rates (diesel) | ↑ | ↑ | ↑ | ↑ |
| | Ratios | ↓ | ↓ | ↓ | ↑ |
| | Other | Number of excises on decline | | . | |
| *Causal Mechanism* | | *Harmonization, strategic Learning* | | *(Competition)* | |

Note: The arrows show in whether the group-specific means or standard deviations for EU vs. OECD countries have increased or decreased in the last 30 years. Blue-shaded areas imply different trends in EU-10 and OECD-11. Causal mechanisms in parentheses show that major hypotheses have limited explanatory power.

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