

Political and Economic Integration in the EU: The Case of Failed Tax Harmonization*

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Abstract

The European Union (EU) tax mandate remains narrow. That there was only a limited transfer of tax authority to the EU exemplifies the failure of political and fiscal integration. Using a political economy framework, this article analyzes why the heads of state rejected tax harmonization proposals in the intergovernmental conferences. The presented findings of the original data on the Maastricht, Nice and Lisbon negotiations support the main hypothesis derived from the theoretical framework – namely that resistance against tax harmonization came predominantly from low-tax countries. Moreover, the results indicate that after the accession of the central and eastern European countries the prospects of harmonizing tax policy starkly decreased. The analysis shows that tax heterogeneity and the enlargements have negative effects on tax integration. Based on the empirical findings and the theoretical framework, the article concludes by discussing how the creation of the monetary union restructured the politics of tax Europeanization and fiscal integration.

Introduction

After the euro crisis started at the end of 2009, the following basic question of integration came again to the fore: should more political integration complement the deep economic integration that has culminated in the creation of the European monetary union? Compared to the creation of the single market and the European monetary union, which mark historically unprecedented levels of economic integration among nation-states, the achievements of political integration remain modest. Politically salient policy areas, such as taxation and welfare redistribution, are still largely nationalized and many consider the political modes of decision-making on the European level to be ineffective.

From a normative perspective, distinct viewpoints have dominated the debates on the ‘right’ integration approach. More EU-sceptic Member States have aimed at restricting integration for economic purposes, focusing on economic concepts such as ‘scale economics’, ‘deregulation’ and ‘the reduction of transaction costs’. For others, however, integration is foremost a political project. The camp of those who advocate political integration has been traditionally split into federalists and pragmatists, a divide that already separated Jean Monnet and Altiero Spinelli. In the 1950s, Spinelli and other

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federalists wanted to start integration with the creation of a federal polity. They endorsed the projects of a European defence and a European political community. Monnet, in contrast, pioneered the 'pragmatic' integration approach. What distinguished Monnet from Spinelli was not that he had opposed political integration, but, for him, a federal polity might have been the end-goal – definitely not the starting point. He suggested that European integration should be a process driven by technical, incremental and concrete economic integration steps that would gradually increase the solidarity among the people of Europe, which then would lay the groundwork for political integration (Monnet, 1976). Monnet's idea to prioritize the economic dimension has been enormously influential. However, economic integration has not spilled over into comprehensive political integration as he anticipated.

From a positivist perspective, which this article adopts, the question is not whether integration should have a political dimension, but why political integration attempts were much less successful than the significant shifts of economic authority to independent supranational actors. By using the term 'political integration', I broadly refer to the political authorities transferred to the European level that are subject to the 'political modes' of decision-making (that is, intergovernmental conferences and legislation via the 'community method') (Scharpf, 2009).

To explain the failures of political integration, this article focuses on the limited European tax authority, which exemplifies the modest achievements of transferring political authority to the European level. Since the 1970s, the European tax and budget competences have only marginally changed: the budget is still very small (a little more than 1 per cent of the EU's gross national income), the tax mandate remains narrow, and the budget and the tax policy-making process are still, by and large, dominated by intergovernmental negotiations (Genschel and Jachtenfuchs, 2011). In the tax field, several attempts have been made to go beyond the unanimity gridlock of intergovernmental decision-making. As in other policy fields, the standard proposal for extending the European tax mandate was to replace the unanimity rule in the Council with qualified majority voting (QMV). In all intergovernmental conferences (IGCs) since Maastricht, the heads of state discussed proposals for introducing QMV in taxation, yet they repeatedly failed.

To analyze this quintessential failure of political integration, I present a political economy framework on the politics of centralizing tax authority at the European level. According to the framework, Member States trade off the potential benefits and costs of europeanization. The main hypothesis derived from that trade-off argument is that low-tax countries are more likely to oppose tax harmonization, while high-tax countries, which are expected to benefit from pooled tax authority, are more likely to support tax harmonization proposals. The main alternative explanation evaluated in the empirical analysis is that the more a Member State's government supports integration in general, the more likely it is to support tax harmonization.

Empirically, I analyze the proposals for introducing QMV in taxation negotiated in the Maastricht, Nice and Lisbon IGCs. The statistical models investigate original data on Member States' positions, which were coded on the basis of negotiation documents. The results support the main hypothesis that low-tax countries were more likely to oppose tax harmonization, but not the alternative explanation that more integrationist governments were more likely to advocate pooled tax authority. The final part of the article discusses

how the two recent landmarks of integration – namely the enlargements and the creation of the monetary union – restructured the politics of tax centralization. The reported empirical findings show that, with the accession of the central and eastern European countries, the support for EU-wide tax harmonization dropped to a record low level. Meanwhile, the euro crisis has led to increased support for further fiscal integration within the eurozone, which might pave the way for future tax centralization proposals targeted to the eurozone.

The remainder of the article is structured as follows. First there is a discussion of political integration since Maastricht, followed by a summary of the limited European tax authority. Then the general argument is outlined and the empirical analysis reported. Finally, effects of the enlargements and the creation of the European monetary union on the politics of tax Europeanization are explored.

I. Political Integration since Maastricht

In the mid-1980s, the heads of state changed the general approach to market integration from the harmonization of rules to the principle of mutual recognition – a paradigm shift pioneered by the European Court of Justice in the *Dassonville* and *Cassis de Dijon* decisions (Scharpf, 2010). Ever since then, a comprehensive European market regime has been established, in which the regulation of economic activity has been outsourced to various specialized supranational agencies (Majone, 1996). Economic activity in the single market is today largely governed by what Scharpf (2009) calls ‘non-political’ modes of EU decision-making. With ‘non-political’ modes, he refers to decision-making that is dominated by independent supranational actors, such as the European Commission and the European Court of Justice, which both have contributed significantly to the creation and functioning of the European market regime. The most recent landmark of an economic authority shift to the supranational level was the transfer of monetary policy authority to the European Central Bank.

While significant economic authority has been transferred to independent supranational actors, policy areas that are considered to be politically sensitive, such as welfare redistribution, defence and taxation, remain subject to the ‘political modes’ of decision-making, which are, again using Scharpf’s (2009, p. 181) terms, ‘those in which member governments have a voice’. Taxation and welfare redistribution are policy areas with economic dimensions too; they are, however, subject to political decision-making (as they cannot be outsourced to independent authorities). Political decision-making includes intergovernmental conferences and legislation via the ‘Community Method’ of co-decision, according to which a qualified majority in the Council decides together with the European Parliament. Critical in political decision-making is the dominant role of Member States’ governments, through which European citizens address their demands. The EU polity is, unlike federal systems, not legitimated ‘as a government of citizens, but as a government of governments’ (Scharpf, 2009, p. 181). In short, political integration is the combination of the comprehensiveness and the effectiveness of European political decision-making.¹

¹ The concepts of ‘political’ and ‘non-political’ modes of decision-making are closely related to the distinction between positive and negative integration (Scharpf, 1999).

The standard integration proposal toward more efficient political decision-making at the European level is the shift from the unanimity rule to QMV in the Council (Pollack, 2003; Scharpf, 2006). At the time of the Maastricht negotiations in 1991, most Member States shared a common understanding that centralized monetary policy had to be accompanied by substantial shifts of political authority to the European level. Proposals were on the table for the introduction of QMV for a broad range of policies; some even asked for the extension of QMV to all areas covered by the treaty. At the final Maastricht summit meeting, however, the negotiations on political union were highly contested. Although most delegations were committed to starting the transformation of the European Community into a full-fledged federal polity, the reference in the treaty to a federal goal was dropped on the very first day of the Maastricht summit (Woolley, 1994).

In the spirit of Monnet's integration approach, many believed that political integration would catch up later. A substantial setback for further political integration was that the French and German positions drifted apart after Maastricht. Among the most committed advocates of the German point of view was the Bundesbank president, Hans Tietmeyer, who repeatedly called for deeper political integration, arguing that the monetary union needed an extensive political underpinning in the form of significant transfers of fiscal, tax and wage authority to the European level. He suggested that only a selected core group of Member States that were willing to pool core state powers should proceed with monetary integration. The French, however, supported a more flexible application of the Maastricht criteria and opposed substantial transfers of national sovereignty.² Without shared and bold German–French support, the extension of QMV to core state functions became practically impossible.

Indeed, at the 1997 IGC in Amsterdam, further extensions of QMV in the Council were not even on the negotiation table (Edwards and Pijpers, 1997). Apart from the political gridlock in the Council, the pledge for the construction of a political union lost support in more general terms. Political scientists began to characterize the model of a supranational regulatory polity without redistribution or taxation mandates as a stable equilibrium and 'logical endpoint' of integration (Majone, 1996; Moravcsik 1998, 2001, p. 163). When, on 1 January 1999, the exchange rates of the 11 euro founding members were locked at fixed rates, nothing like a comprehensive political union with centralized fiscal, tax and wage authorities complemented this historically unprecedented peak of economic integration among nation-states. The German government, backed by central bankers, still insisted that the harmonization of taxes and a genuine European revenue source were imperative elements of a European financial governance capacity needed after the introduction of the euro. However, in both the Nice and the Lisbon IGCs, the heads of state again rejected fiscal and tax Europeanization proposals.³

In sum, integration was successful with respect to regulatory authority transfers to independent supranational institutions, while proposals to strengthen the political dimension of integration, including the transfer of fiscal and tax authority, largely failed. Taxation is of particular interest in that respect because, at least on the European continent, establishing tax authority has been the critical step in state-making (Tilly, 1985).

² For the diverging German and French positions, see, for example, *Frankfurter Allgemeine Zeitung*, 8 September 1994, 4 November 1994, 1 January 1995, 4 April 1995, 19 October 1995; *Financial Times*, 6 June 1994.

³ For the discussions at the Nice IGC, see CONFER 4707/00, 4734/00, 4737/00, 4750/00, 4753/00, 4767/00, 4770/00. For Lisbon, see CIG 38/03.

II. The Limited European Tax Authority and Its Consequence

Which tax authorities have been Europeanized, and which are the most important EU tax integration proposals that have been discussed so far? In general, tax competence can be shifted to the European level in two ways: first, by creating a genuine EU tax source, and second, by harmonizing national tax laws. The following discussion shows that on both these dimensions the EU tax authority remains modest. The limited EU tax authority highlights the modest achievements of political integration, given that the financing and spending activities of political units reflect the extent and nature of the mandate that people delegate to their political authorities.

In the initial years of integration, the budget of the European Community was comparable to the financing of other international organizations. Later on, in the 1970s, the heads of state created a system of 'own resources', based on custom duties, agricultural levies and value added tax proportions, and they assigned budgetary competences to the European Parliament. Consistent with the model of a federal polity, integration seemed to be on a path toward a fiscal federal structure with comprehensive European financial resources that were independent from national politics. During the 1980s and 1990s, however, the view prevailed that the EU does not need its own sizeable resources. In line with this paradigm shift, national contributions that are calculated based on Member States' gross national incomes became the major funding source for the budget. After that change in the revenue structure, the lion's share of the EU budget was no longer funded with 'own resources', but with national lump-sum contributions (Laffan, 1997).

Nowadays, the main principles of the budget are that expenditures and revenues must match and that the budget cannot exceed 1.23 per cent of the EU's gross national income. These budget rules starkly constrain the financial governance capacity of the EU. Pursuing macroeconomic stabilization policy, for example, is practically impossible with such a small budget. Although the Commission and the European Parliament are involved, budget-making is still largely an intergovernmental process (Lindner, 2005).⁴ The European Parliament traditionally requests that more EU spending should be financed with a European tax. A financial transaction tax is the most recent of several initiatives for tax-based financing of the EU. Various tax instruments, such as a modulated value added tax, a corporate income tax and a tax on environmental pollution, have been proposed and were often passionately advocated in official reports and academic studies (Le Cacheux, 2007; Lang and Zagler, 2010). However, the Council was never close to a unanimous agreement in favour of the introduction of a European tax.

Apart from creating a genuine EU tax source, the harmonization of national tax systems is the second mechanism of how tax authority can be shifted to the European level. The Treaty on the Functioning of the European Union (TFEU) includes several articles on tax harmonization, which suggest, however, that there is only very limited *de jure* interference at the European level.⁵ For example, direct taxation is not even mentioned in the TFEU. The value added tax is largely harmonized through secondary legislation, while direct taxes, such as corporate taxes, are not harmonized at all. In the case of the tax provisions that are listed, such as indirect taxation, the Council can only act

⁴ The specific institutional rules are as follows: the Commission makes a proposal for a so-called 'multiannual financial framework' (MFF), which has to pass a unanimous vote in the Council and a majority vote in the European Parliament.

⁵ TFEU, Articles 110–113.

unanimously after consulting with the European Parliament. All European tax authorities are directly linked to the functioning of the single market. Furthermore, the European Commission tried to advance European tax legislation by focusing on the removal of tax obstacles for multinational businesses and the prevention of detrimental tax competition (Devereux, 2004).⁶ An initiative that was eventually adopted by the Council is the so-called ‘code of conduct for business taxation’. The resolution addresses ‘harmful’ tax competition. Yet the effectiveness of the resolution is controversial; some even argue that it further accelerated tax competition. Overall, the Commission’s tax activities had only a limited impact (Radaelli and Kraemer, 2008). If one considers the limited scope of tax harmonization legislation, one might conclude that Member States could keep full national sovereignty in taxation.

Arguing against that common interpretation, Genschel and Jachtenfuchs (2011; 2013) show that the regulatory regime of the single market increasingly constrains national tax authority and that, *de facto*, market integration has largely undermined national tax sovereignty. One of the starkest impacts on national tax sovereignty stems from the nexus between market integration and transnational business activity. From a single-market perspective, national tax laws are problematic because they conflict with the non-discrimination principle and the free movement of services and capital. Referring to those single-market paradigms, the European Court of Justice has overruled several national tax provisions (Graetz and Warren, 2006, 2007). From a national perspective, however, the enforcement of these principles is problematic because they conflict with national fiscal interests. The removal of national barriers has, according to several studies, intensified corporate tax competition within the EU, which limits national tax revenue capacities (Sinn, 2003; Zodrow, 2003; Ganghof and Genschel, 2008; Genschel *et al.*, 2011; Rixen and Schwarz, 2012). Although there is a clear trade-off between national fiscal interests and single-market principles, EU legislation balancing these conflicting goals is largely absent because Member States cannot unanimously agree on tax proposals.

Being aware that the veto power of individual Member States causes gridlock and standstill, several Member States have repeatedly made the proposal to introduce QMV for certain tax matters to harmonize tax laws and to pool some tax authority on the European level. In the Maastricht IGC, the heads of state discussed a proposal for the introduction of QMV to harmonize indirect and corporate taxation. Later, in the Nice and Lisbon IGCs, the proposals for introducing QMV listed measures directly linked to the single market. The next section analyzes theoretically and empirically why these proposals repeatedly failed.

III. The Politics of Tax Harmonization

Why were some Member States more likely to oppose the introduction of QMV in taxation than others? To answer this question, I proceed as follows: first, I present a general political economy framework on the politics of pooling authority at the European level; second, I apply the argument of the general framework to the case of tax politics; third, I present empirical findings of the Maastricht, Nice and Lisbon IGCs; and finally, I

⁶ See, for example, European Commission, Report of the Committee of Independent Experts on Company Taxation (Ruding Report), March 1992; SEC(96) 487; SEC(2001) 1681; COM(2001) 582; Resolution of the Council on a code of conduct for business taxation. *Official Journal of the European Communities*, C2, 1998.

discuss how the accession of the central and eastern European countries as well as the creation of the monetary union have restructured the politics of tax centralization.

The General Argument

The basic argument of the political economy framework adopted in this article is that the pooling of any authority in a community is associated with costs and benefits for the affected units. Centralization typically internalizes costs and takes advantage of scale economics, but it is also associated with costs because, after pooling, the individual units cannot legislate anymore according to the specific preferences of the people in their jurisdictions. Starting from that premise, Frieden (2004) analyzed several bargaining equilibria with and without centralized authority at the EU level. The key finding of Frieden's theoretical study is the identification of the trade-off between the benefits of centralization and the costs of overriding heterogeneous preferences, which he considers to be the 'most important and richest [observation] in implications' for the study of 'the choices EU members face when considering centralizing authority at the European level' (Frieden, 2004, p. 269).

Alesina and Wacziarg (1999) discuss a similar model that weighs the benefits of shifting authorities to the central level against the costs that centralization imposes on a heterogeneous group of countries. Simply put, Member States' representatives are expected to support the pooling of authority at the European level when they anticipate that centralization comes with benefits that justify giving up veto power. However, the calculation of costs and benefits varies across countries. In the case of taxation, harmonization proposals are directly linked to single-market tax competition, and the harmonization of tax systems is associated with tax competition constraints. This is critical for the general cost–benefit argument because constraining tax competition is beneficial for countries that have lost tax revenue due to tax competition, while it is costly for Member States that have benefited from competitive dynamics.

Asymmetric Tax Competition and the Politics of Tax Harmonization

To disentangle the cost–benefit effects of tax competition in more detail, let us start with the benefit side of the equation. Genschel and Jachtenfuchs (2011, 2013) convincingly document that the creation of the single market limits the national room to manoeuvre in taxation, and empirical research has consistently shown that national tax revenue capacities are constrained because the creation of the single market has led to intense tax competition (Sinn, 2003; Zodrow, 2003; Ganghof and Genschel, 2008; Rixen and Schwarz, 2012). The jurisprudence of the European Court of Justice, which prioritizes single-market principles *vis-à-vis* national fiscal interests, adds to the creeping undermining of national tax sovereignty (Graetz and Warren, 2006, 2007; Genschel *et al.*, 2011; Höpner and Schäfer, 2012). Within that general set-up, two mechanisms account for the potential beneficial effects of pooling tax authority at the European level. First, assuming that European tax harmonization will lead to EU legislation balancing single-market principles and national fiscal interests, Member States would regain some authority over their tax revenue capacities. And second, European tax legislation is associated with economic gains because tax harmonization internalizes costs that heterogeneous tax

systems impose on private actors. There is, for example, the potential that corporate tax harmonization facilitates and fosters transnational business activity.

These positive effects of pooling tax authority are fairly general, yet the cost–benefit structures of individual Member States vary. The theoretical and empirical findings of the tax competition literature offer an account for this variation. Theoretical research has highlighted that tax competition leads, under certain conditions, to asymmetric allocations of pay-offs and burdens (Dehejia and Genschel, 1999). Theoretical models show that some units with specific characteristics benefit from tax competition at the expense of others. Empirical studies have detected these kinds of asymmetric outcomes and dynamics in the case of corporate tax competition in the single market (Ganghof and Genschel, 2008), which has the following implications for the politics of tax harmonization: countries that benefit from tax competition dynamics, which are typically low-tax countries, have no material interest in supporting tax harmonization; they are, therefore, more likely to oppose the pooling of tax authority.

Accordingly, a reasonable approximation of the cost–benefit calculation of Member States in single-market tax competition is that low-tax countries benefit from tax competition and that they are more likely to oppose the pooling of tax authority. The opposite is true for high-tax countries that might have lost tax revenue due to tax competition. For them, regaining tax authority at the European level is attractive, given that they expect the benefits of common European tax legislation to dominate. In addition, variation in taxation levels also approximates variation in political adjustment costs. Frieden (2004, p. 265) points to an important implication of the discussed political economy framework by stating that ‘preference outliers tend to oppose centralization’. In the tax case, the critical outliers are the low-tax countries, which have a preference for lower taxes. They are, compared to high-tax countries, more reluctant to support tax harmonization proposals because for them the political adjustment costs of harmonization are likely to be higher. The asymmetric tax competition and the political adjustment cost arguments reinforce one another and lead to the following hypothesis:

High-tax Member States are more likely to support tax authority shifts to the European level, while low-tax Member States oppose such reform proposals.

This general formulation of the hypothesis does not discriminate among different tax sources. A more nuanced formulation of the hypothesis points to the variation in corporate tax levels because tax competition in the single market largely revolves around corporate taxation. Thus, we should expect that countries with low corporate tax levels are more likely to oppose tax harmonization. The main alternative explanation, against which these hypotheses will be tested, suggests that the more favourable a Member State’s government is toward integration in general, the more likely is its support for tax centralization.

Empirical Analysis

Qualitative evidence supports the argument that high-tax countries were more likely to advocate the pooling of tax authority. Belgium, for example, a high-tax country in the EU, has been one of the most persistent proponents of tax harmonization. During the Maas-tricht negotiations, Belgian Minister of Finance Philippe Maystadt proposed QMV in the Council. The reasoning for the proposal anticipated the upcoming tax competition effects

of the single market and outlined a major obstacle for the extension of QMV in taxation by stating that '[c]ountries with lower taxes' were 'naturally tempted to block' tax harmonization.⁷

Since Maastricht, proposals for QMV were on the table at all subsequent IGCs, but they repeatedly failed. Extensively discussed was the introduction of QMV for tax matters in the Maastricht, Nice and Lisbon IGCs. For the following quantitative analysis, I coded, as the dependent variable, whether a Member State's delegation supported the introduction of QMV in tax matters. Member States do not vote in IGCs, which are organized as negotiation processes that have to bring about unanimous solutions. Although there are no formal votes on specific proposals, it is nonetheless possible to gather information about Member States' preferences by analyzing preparatory negotiation documents in which Member States' delegations outline their positions. Official IGC documents on Member States' positions regarding the introduction of QMV in taxation are available for the Maastricht and Nice IGCs. Based on such primary sources, I collected original data on whether a country supported proposals for the introduction of QMV or not; in a few cases, I had to rely on secondary sources. In the case of the Lisbon IGC, I used the data on Member States' negotiation positions gathered by the researchers of the DOSEI project.⁸

To evaluate empirically whether low-tax countries were more likely to oppose the pooling of tax authority, I coded, as the main explanatory variables, total taxes as a share of gross domestic product (GDP), which is a standard aggregate measure of a country's tax level, as well as the top corporate tax rate. I operationalize the alternative explanation – namely that support for tax harmonization is a function of how pro-integrationist a Member State's government is – using various series of the Chapel Hill expert survey, which report party positions based on expert surveys (Steenbergen and Marks, 2007; Hooghe *et al.*, 2010). The experts classify each party on a 1–7 scale, ranging from the general statement that a party 'strongly opposes European integration' to the judgement that a party is 'strongly in favour of integration'. I derived from the party position data a government position measure on general integration support by weighting the estimates of the government parties according to the cabinet seat shares.

Please note that the following statistical analysis comes with limitations. A major restriction is the small sample size (the Maastricht Treaty was negotiated among the EU-12 and the Nice Treaty among the EU-15). Due to the data limitations, the findings are more illustrative than conclusive.⁹

Table 1 reports the findings of the models for the Maastricht, Nice and Lisbon IGCs, which estimate the effects of a country's taxation level and the overall orientation of its government toward integration on the probability of support for the introduction of QMV in taxation. What the estimates show is that the general tax level variable (that is, total taxation as a share of GDP) predicts at fairly low significance levels whether a Member State supported the pooling of tax authority in the cases of the Maastricht and Nice IGCs. The lower a country's tax level, the more likely it was to oppose the introduction of QMV. In the Lisbon model, the general tax level variable has no systematic effect on Member

⁷ CONF UP-UEM 2001/91, p. 2.

⁸ As there were no substantial discussions on the introduction of QMV during the Amsterdam negotiations I was unable to collect data for this IGC. Many thanks to Thomas König, the co-ordinator of the project on Domestic Structures and European Integration (DOSEI), for sharing data (König and Hug, 2006).

⁹ For more information on the coding and the sources of the variables, see the online Appendix.

Table 1: Predicting the Support for QVM in Taxation for the Maastricht, Nice and Lisbon IGCs

	<i>Maastricht (1991)</i>	<i>Nice (2000)</i>	<i>Lisbon (2004)</i>
Total tax as share of GDP	0.190** (0.090)	0.188* (0.112)	-0.037 (0.059)
Top corporate tax	0.076 (0.079)	0.111 (0.087)	0.124** (0.056)
General integration support	1.715 (1.892)	1.797 (1.197)	0.757 (0.508)
N	EU-12	EU-15	EU-25

Source: Author's own calculations.

Notes: Probit model estimates; standard errors in parentheses. ** $p < 5$ per cent; * $p < 10$ per cent.

States' positions, while the top corporate tax rate predicts quite precisely whether a Member State supported the pooling of tax authority. Countries taxing corporations at lower levels were less likely to support the introduction of QMV in taxation in the negotiations among the EU-25.

The findings suggest that intensified corporate tax competition in the single market, after the enlargements, has concentrated the cleavage between countries that support tax harmonization versus those that oppose it around corporate taxation levels. While general tax levels were critical in Maastricht and Nice, Member State governments focused, after the accession of the central and eastern European countries, on their relative corporate tax levels for evaluating whether common tax policies are beneficial for their country. Finally, the coefficients of the general integration support variable have the expected sign in each of the three models, but they do not meet conventional significance levels.¹⁰

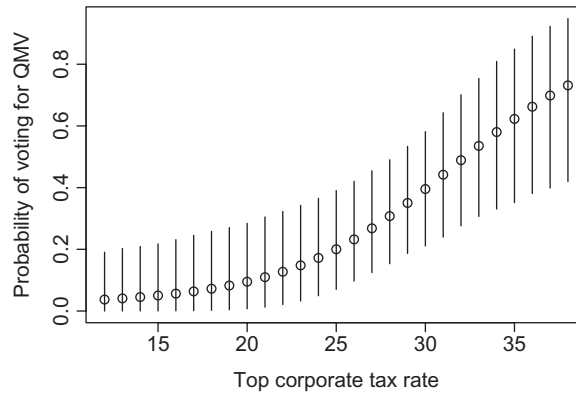
We cannot directly interpret the size of the effects reported in Table 1. However, based on the model estimates, we can simulate the predicted probability that a country supported the introduction of QMV. Let us first discuss the size of the effect of the total tax variable in the Maastricht and Nice IGCs. One extreme case is the low-tax country of Luxembourg. The estimates of the Maastricht and the Nice models predict a low probability that the delegation of Luxembourg supported the introduction of QMV, going from 24 per cent in Maastricht to 36 per cent in Nice. Another extreme case is Luxembourg's neighbour: the high-tax country of Belgium. The predicted probability that the Belgian delegation backed the introduction of QMV was very high according to the model estimates: 79 per cent in Maastricht and 89 per cent in Nice.¹¹

Figure 1 plots the size of the corporate tax effect in the Lisbon model. The simulated probabilities show that, after the accession of the central and eastern European countries, Member States with lower corporate tax rates were much less likely to support tax harmonization than Member States taxing corporations at high levels. The size of the effect is substantial. According to the model, countries with corporate tax rates below 20 per cent clearly opposed the pooling of tax authority. The 90 per cent confidence interval indicates that the probability that a country with a corporate tax rate of 20 per cent supported the introduction of QMV in taxation was between 0 and 26 per cent (five of the

¹⁰ For additional model specifications using variance-weighted least square estimation, see the online Appendix. The findings are robust. The only difference is that the variance weighted least square estimates provide some weak empirical support for the alternative explanation that more pro-integrationist governments were more likely to support the introduction of QMV.

¹¹ The 90 per cent confidence intervals of the reported model simulations are as follows: Luxembourg 1–66 per cent in Maastricht and 12–66 per cent in Nice, Belgium 47–98 per cent in Maastricht and 58–99 per cent in Nice.

Figure 1: Simulated Probabilities that a Member State Supported the Introduction of QMV Based on the Top Corporate Tax Level in the Lisbon IGC



Source: Author's own calculations.

Notes: Shown are the predicted probabilities and the 90 per cent confidence intervals. The simulations are based on the estimates reported in Table 1.

25 countries had a top corporate tax rate below 20 per cent). High-tax countries, in contrast, were quite likely to support tax harmonization. For countries that tax at a high level of 35 per cent, the 90 per cent confidence interval shows a 36–88 per cent probability of support (six of the 25 countries had a top corporate of 35 per cent or higher).

In sum, the empirical findings show that tax variation predicts quite precisely the positions of Member States in the negotiations on the introduction of QMV, which lends support to the argument that tax heterogeneity is the critical factor in the politics of tax harmonization.

The Enlargement Effect

The reported findings are particularly interesting with respect to the effects of enlargement. The empirical results show that, in the EU-12 and the EU-15, Member States with low total taxes were more likely to oppose tax harmonization, whereas, in the EU-25, the Member States taxing corporations at low levels were more likely to reject the introduction of QMV in taxation, which indicates that the cleavage in the politics of tax harmonization centred, after enlargement, around corporate taxation. This interpretation resonates with the recent empirical research showing that corporate tax competition in the single market has intensified since the accession of the central and eastern European countries (Genschel *et al.*, 2011).

The political economy framework adopted in this article is useful for further analyzing the implications of enlargement on the politics of tax harmonization. The elaborated argument suggests that increased tax heterogeneity and accelerated tax competition sharpen the divide between advocates and opponents of tax harmonization, which, in effect, is likely to narrow the overall support for the pooling of tax authority (Alesina and Wacziarg, 1999; Höpner and Schäfer, 2012). Simply put, increased tax heterogeneity leads to reduced support for tax harmonization. Table 2 shows that, in the Maastricht and

Table 2: Share of Support for QMV in Taxation in the Maastricht, Nice and Lisbon IGCs (%)

	<i>Maastricht (1991)</i>	<i>Nice (2000)</i>	<i>Lisbon (2004)</i>
Share of support for QMV in taxation	50	47	32
	EU-12	EU-15	EU-25

Source: Authors' own calculations.

Nice negotiations, about half of the Member States supported the introduction of QMV in taxation. After the accession of the central and eastern European countries, the share of support for QMV dropped to just about a third. As expected, increased tax heterogeneity, after enlargement, made tax harmonization even more unlikely than it was before.

Tax Centralization within the Monetary Union?

The other recent landmark of integration – the introduction of the euro – has also starkly restructured the politics of tax centralization, although in a quite different way than enlargement. Whereas the accession of the central and eastern European countries led to decreased overall support for EU tax harmonization because tax heterogeneity among the Member States increased, the establishment of the European monetary union created a new and powerful segment of potential benefits of pooled tax authority within the eurozone. However, not tax harmonization, but the other mechanism of pooling tax authority at the European level – namely the creation of a genuine EU tax source – may dominate the discussions on the politics of tax centralization within the eurozone. While tax harmonization is connected to single-market considerations, the creation of the monetary union is associated with increased demands for more centralized spending within the eurozone that could be financed with a genuine European tax.

The new segment of potential benefits of pooled tax authority within the eurozone is a consequence of Monnet's integration approach, whose core dynamic is based on the fact that the benefits of shifting more authority to the European level increase, the more tasks have already been Europeanized. The benefits of additional Europeanization depend not just on how many authorities have already been Europeanized, but also on how far-reaching they are. In that respect, giving up monetary autonomy was a truly momentous decision. The creators of the monetary union explicitly aimed to stimulate integration with the introduction of a single currency, expecting that this will lead to Europeanized economic and fiscal policies. Section I documented how German officials, in particular, repeatedly insisted that the pooling of tax authority should complement the Europeanization of monetary policy. Although the creation of the monetary union has not (yet) led to more tax centralization, it has shifted the material focus of the discussions away from single-market competition arguments toward macroeconomic stabilization concerns.

Most important is that the centralization of monetary policy made the centralization of fiscal and tax policies within the eurozone more beneficial. In the current economic crisis, many argue that closer macroeconomic co-ordination and more common spending financed with a European tax were effective instruments to counter-balance regional

and national economic shocks within the eurozone (Obstfeld, 1997; Thygesen, 1999; De Grauwe, 2007; Scharpf, 2011). Macroeconomic analysis and the fiscal federalism literature support the argument that the central level is superior to the sub-central level in the management of macroeconomic stabilization (Rodden and Wibbels, 2010; Bordo *et al.*, 2013). One of the most committed advocates of substantial common spending within the eurozone is De Grauwe (2006, p. 2), who argues that a centralized budget is an essential element of a sustainable monetary union and that this analysis ‘seems to have history on its side’ because a functioning monetary union in the absence of pooled tax and spending authority is without precedent.

Since the start of the euro crisis at the end of 2009, the support for fiscal integration within the eurozone has gained support. Moreover, the negotiations in the Council are increasingly shaped by the interest cleavage between the eurozone and the non-eurozone countries. It is thus possible that upcoming proposals for pooled tax authority no longer will be formulated for the whole EU, but that they will be restricted to the eurozone, and that they will be designed based on the needs of the monetary union (not on pressures stemming from the single market). Although we should be careful in extrapolating the presented analysis of tax harmonization on the politics of tax centralization within the eurozone because the interest structure will be distinct, the general political economy argument discussed in this article provides a useful analytical framework for formulating expectations about eventual eurozone tax centralization politics: for example, the general argument put forward suggests that countries that are hard-hit by the recent economic shocks will be particularly likely to support proposals for pooled tax authority within the eurozone because they will benefit disproportionately from enhanced common spending within the eurozone. However, formulating such expectations is still premature, given that the eurozone still lacks comprehensive political institutions.

Conclusions

This article has analyzed the politics of failed tax harmonization using a political economy model on the trade-off between the benefits of pooling tax authority and the costs of overriding heterogeneous preferences. The main argument put forward hypothesizes that low-tax countries are more likely to oppose the pooling of tax authority because, for them, European tax intervention is associated with higher costs, while high-tax countries are more likely to support tax harmonization. The empirical analysis of the original data of the Maastricht, Nice and Lisbon IGCs supports the main argument of the article and indicates that its explanatory power is greater than that of the discussed alternative explanation, which predicts that support for tax centralization depends on the extent to which a Member State’s government is generally ‘pro-integrationist’. The reported findings also show that increased tax heterogeneity after the accession of the central and eastern European countries reduced the prospects for successful tax centralization.

The basic argument discussed here might seem uncontroversial. Yet I would argue that the implications are stark and deserve attention. For example, the presented analysis highlights that asymmetric cost–benefit calculations are critical drivers of tax centralization politics. Asymmetric pay-offs could be taken into account in tax Europeanization proposals by including side-payments. As far as I know, this has not been done in the

proposals discussed so far. Moreover, the analysis has shown that the limited prospects for tax harmonization have further decreased after the enlargements, which is not good news for those who are concerned that single-market principles undermine national tax authority. Meanwhile, single-market principles that limit the national room to manoeuvre in taxation will most likely continue to be enforced through the jurisprudence of the European Court of Justice.

Instead of pursuing tax centralization among all EU Member States, the focus seems to shift toward more fiscal integration within the eurozone. Given that the euro crisis has sharpened the awareness that closer macroeconomic co-ordination and substantial European financial governance capacities are essential to counter-balance regional and national economic shocks, calls for more fiscal integration have gained momentum. Since the euro crisis started, Member States' cost-benefit perceptions of fiscal integration have radically changed. There is now a clear distinction between the countries within and outside the monetary union. The finance ministers and heads of state of the eurozone countries meet regularly among themselves. One possible outcome of that general development is that the eurozone countries will start establishing political institutions with taxation and spending mandates for the monetary union. An important step in that direction would be a reform of the European Parliament, as advocated by German Finance Minister Wolfgang Schäuble. He has suggested that only the MPs of the eurozone countries should meet to make decisions related to the eurozone. In addition, proposals for the introduction of a eurozone budget that could finance macroeconomic stabilization policies have also already been drafted. However, before budget and tax authority is centralized within the eurozone, institutions that can make political decisions for the eurozone area should be established. This is simply because the basic principle that there is no taxation without representation can be met only when political institutions for the eurozone area are created in the first place.

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Supporting Information

Additional Supporting Information may be found in the online version of this article at the publisher's web-site:

Table S1: Data and Coding

Table S2: Data and Sources

Table S3: Predicting the support for QMV in taxation for the Maastricht, Nice, and Lisbon IGCs. Variance-weighted least square regression estimates; standard errors in parentheses; *** $p < 1\%$, ** $p < 5\%$; * $p < 10\%$.