

EMU: The Tax Challenges Ahead

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On 1 January 1994 the second stage of Economic and Monetary Union came into effect after a lengthy and laborious ratification process of the Treaty on the European Union, better known as the Maastricht Treaty. The purpose of this stage two is a direct preparation of full Economic and Monetary Union with one single European currency by the turn of the century.

Belgium held the presidency during the period immediately preceding the start of stage two under extremely difficult circumstances. The economic recession increased the tendency of the Member States to rely on national policy instruments to turn the tide. The problem, however, is not so much a readjustment of economic policies between the Member States. The basic problem in the Community is a readjustment between West and East in the world economy, whereby all Member States are caught in the same boat. Readjustment on such a world scale needs economic policies on a continental scale. When Member States would retrench themselves in defence behind national economic policies, this would only result in a single market of close neighbours begging each other, with competitive fiscal and social policy measures. Therefore the economic recession has strengthened the case for a full Economic and Monetary Union, not as an area of unfettered, cut throat competition, but as an area of efficient allocation of resources based on competition, within a minimal social framework, that will be upheld and defended worldwide.

If these are our objectives, the question then is what are the matching tax policies to be pursued by the Community? The answer is clear: if we wish to avoid cut throat tax competition between Member States, we should, in preparation of full Economic and Monetary Union, establish tax rules with minimal coherence in the Community, which would allow Member States to coordinate their tax policies, while maintaining to a large extent, at least in stage two of EMU, their fiscal sovereignty.

The model to proceed is what has been achieved in the area of VAT. This tax has been harmonised to a large extent and yet the Member States are still very much in control of its national budgetary consequences.

The top priorities in stage two are in the area of corporate income tax, taxation of savings, and taxation of transport, there being a basic difference in the two first categories and the latter one.

With respect to taxation of transport the main task is to establish a level playing field within the Community, whereby the impact of third countries of Community tax coherence is negligible. It involves mainly a readjustment of excises on fuel and road taxes.

With respect to corporate income tax and taxation on savings the situation is basically different. Establishing a level playing field in the Community is inextricably linked with the establishment of a common tax policy towards third countries. Just as the common outside tariff is essential for the elimination of all tariffs and indirect taxes on intra-community trade of goods, the establishment of a minimal common tax policy with regard to third countries is essential to achieve a level playing field within the Community.

Also taxation of savings is inextricably linked to corporate income tax. It does not make sense to establish a level playing field for companies, while maintaining considerable tax differences between Member States in the tax regimes of savings from which the same companies are financed.

So the challenges ahead are clear. The Community should think of a minimal common tax policy towards third countries, which implies coordination of negotiations and renegotiations of tax treaties at the Community level.

With respect to taxation of savings an equitable solution should be sought between the claims of source countries and residence countries, whereby systems of withholding taxes on income from capital should be made compatible with systems of taxation on the basis of reporting such income.

When the two aforementioned conditions are met, the Community could go ahead with the proposed measures for the tax liberalisation of income from capital (interest, royalties), which have been languishing in the files of the Commission.

Minimal guideposts for corporate income tax with respect to rates and rules defining the tax base should also be established, setting out a minimal common framework for corporate income tax, within which the Member States should still maintain a considerable degree of tax autonomy.

These are the fiscal preconditions for stage three. There can be no full Economic and Monetary Union with one single currency, when Member States would continue to pursue basically different income tax policies with respect to income of non residents and to maintain basically different corporate income tax systems as they exist today. This does not mean that Member States will lose their fiscal sovereignty. They still will be largely in control of the budgetary implications of their corporate income tax, like they are in control of the budgetary implications for VAT today and they will rather increase their control on taxation of savings, if compared to the situation today. The only difference will be that there will be common rules of reference that will define the playing field and admittedly restrict their range of decision making. It is a small price to pay however. If Member States would insist on maintaining unfettered fiscal sovereignty as it existed before the Treaty of Rome, their tax policies will be controlled by the turn of the century not by national or European institutions but by world markets and institutions far away.