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The political economy of corporate tax harmonization — Why do European politicians (dis)like minimum tax rates? ☆

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ABSTRACT

Setting minimum tax rates is a well discussed way of mitigating pressure from tax competition. This paper investigates which motives shape the support for a minimum corporate tax among politicians. We make use of a unique data base: a survey among members of the European parliament. Our results confirm that the politicians' ideology as well as individual characteristics such as educational background exert a major influence. Moreover, several predictions regarding national interests are derived from various standard tax competition models. These hypotheses are partly supported by the data; in particular, different national preferences towards social equality shape the support. A comparison with survey results from the German Bundestag reveals that German politicians on the national level do not show different attitudes towards tax rate harmonization.

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1. Introduction

Corporate tax harmonization is a much discussed subject in politics. Supported by the findings of neoclassical standard tax competition models, political representatives repeatedly argue that globalization might lead to a destructive competition which would result in a "race to the bottom" of tax rates and an insufficient financial endowment of the public authorities. However, an international coordination of corporate tax policies is difficult in practice since individual actors may usually gain from a unilateral deviation of their tax policy.

One existing supranational institution which could ensure a coordinated tax policy of a subgroup of nations is the European Union. In Europe, there are pronounced concerns about the consequences of corporate tax competition, especially since the accession of Central and Eastern European countries with low corporate taxes to the EU. Although the Ruding Report on Company Taxation (Commission of the European Communities, 1992) already proposed to introduce an EU-wide obligatory corporate tax rate of 30% in the year 1992, European legislators have been remarkably calm regarding advances in this direction in the past years. Nevertheless, both in the political debate and in the economic literature, it is still a debated issue whether the European level should get involved in this area and restrict tax competition by means of an obligatory minimum corporate tax rate.

☆ The paper was written while Steffen Osterloh was working at ZEW Mannheim. The opinions expressed in this paper reflect the personal views of the authors and not necessarily those of the German Council of Economic Experts.

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While there exists a vast theoretical and empirical literature on the controversial issue whether corporate tax coordination is capable of improving welfare or not as compared to unrestricted competition, the positive question on the driving forces of harmonization processes has largely been ignored. Despite the fact that a few authors have formulated certain presumptions on the conditions under which harmonization takes place as well as the probable view of decision makers in parliaments, rigorous empirical tests on such hypotheses are missing. This paper contributes to filling this gap. We want to explore the preference-shaping factors of policy actors with respect to their position on corporate tax coordination in general and on an EU-wide minimum tax in particular.

There are a number of factors which can be expected to influence attitudes in this regard, both on the individual and on the country-specific level. Individual factors can mainly be derived from ideological preferences, as it may be assumed that the attitudes towards the role of the government and national sovereignty have an influence; however, they can also be derived from personal background such as education. Country-specific factors arise from different attitudes towards the size of the national welfare state and national tax autonomy, as well as the extent to which a country can benefit from the autonomy to pursue an independent tax policy.

In our approach, we rely on the use of an elite survey among parliamentarians,[1] an approach which is quite common in political science but has not been applied frequently in public economics (e.g., Ashworth and Heyndels, 1997, 2000; Heinemann and Janeba, 2011). As it is one of our prime concerns to identify aspects which are related to national characteristics, we chose the Members of the European Parliament (MEP) as our target group. Although these politicians do not have a direct say in the corporate tax policies of today, they constitute an interesting subject of research. In contrast to national parliaments, where all parliamentarians share the same national perspective and analyses can only focus on differences in ideology and individual background of the parliamentarians, in the EP perceptions from all 27 EU member states come together. Compared to analyses involving representatives from several different national parliaments, the focus on MEPs offers the advantage that they operate in the identical institutional environment. For this reason, their attitudes cannot be assumed to be biased due to specific characteristics of national parliaments. Members of different national parliaments might have a different degree of knowledge of the issue (whereas MEPs have similar levels of information due to cooperation in supranational political groups and committees), different national reelection concerns due to asynchronous legislative terms (whereas in the EP elections take place simultaneously in all countries) and constituency-specific interests (whereas all MEPs are elected under proportional representation from party lists, even in countries such as the UK that apply a plurality voting system in national elections).

We make use of a unique data base: a self-conducted survey among MEPs, which asked directly for the desirability of EU-wide obligatory minimum corporate tax rates. Moreover, this study makes additional use of an analogous survey, which was directed at members of the German parliament, the Bundestag. This comparison is helpful, since these parliamentarians have, in contrast to the MEPs, the competence to decide on corporate taxation issues. In order to draw more general conclusions which are not only restricted to MEPs, one has to assume that politicians of a given country and party are 'similar'. The similarity of attitudes towards tax harmonization will be analyzed in the empirical section for German politicians from these different parliaments. Based on these databases our study is the first to shed light on the positive question of how to comprehend the diversity of attitudes of politicians on corporate tax competition and to understand the lack of harmonization even in an integrated economic area such as the EU.

The main results of this paper can be summarized as follows. The important role of ideology can be confirmed, but we also demonstrate that both further individual characteristics as well as national interests proxied by country variables are important determinants for the politicians' attitudes towards limiting corporate tax competition by means of minimum tax rates. It is mainly parliamentarians from countries which exhibit a high corporate tax burden today who express their approval for minimum tax rates. Several predictions of theory derived from tax competition models can be confirmed, while others do not find support. However, no evidence can be found that the attitude of German representatives of the Bundestag differs from that of their counterparts in the European Parliament.

The structure of our paper is as follows: in Section 2, the theoretical background for our analysis is presented, which is mainly based on the literature on tax competition and on several approaches from the political science literature. On this basis, our testable approach to preference formation is developed in Section 3. In Section 4, the surveys of members of the European Parliament and the German Bundestag are described and descriptive findings are presented. Section 5 presents the empirical analysis and the estimation results. Section 6 concludes.

2. Theoretical background

2.1. Tax harmonization

The theoretical literature on tax coordination in the European Union, such as Zodrow (2003) or Oates (2001), has until now mainly focused on the normative question whether coordination of tax policies is welfare-increasing compared to competition. In this literature, which originated from the seminal contribution by Zodrow and Mieszkowski (1986), tax coordination gets its support from the view which regards corporate tax competition as being detrimental, since a "race to the bottom" of corporate tax rates endangers the financing base of the welfare state; in this case, a coordinated approach would be welfare-enhancing. In its application to EU tax policy, Zodrow (2003: 655) concludes that "the standard tax competition model suggests a potential role for

[1] Elite surveys on members of the executive branch of government, such as heads of government or ministers, are quasi unfeasible at the national level due to very low rates of response and econometrically unhelpful due to too few observations.

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