

THE CODE OF CONDUCT AGAINST HARMFUL TAX COMPETITION: OPEN METHOD OF COORDINATION IN DISGUISE?

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The European Union is experimenting with new, non-binding policy instruments in business taxation, namely a voluntary code of conduct among member states against harmful tax competition. This article raises the question to what extent can the code be considered a manifestation of the open method of coordination (OMC)? Is an open method (based on guidelines, peer review, best practice, benchmarking, learning and diffusion of shared beliefs among policy-makers) emerging as a new governance architecture in tax policy? If so, what can the code achieve in terms of policy learning and convergence? There are similarities between the code and the open method of coordination – especially with reference to guidelines, peer review, time-tables and the identification of ‘worst practice’. However, the political logic of the code does not fit in well with the OMC aims of participatory governance and social learning. In terms of achievements, the code has contributed to the creation of a community of discourse and the diffusion of shared beliefs about what constitutes ‘acceptable’ and ‘harmful’ tax competition. Convergence at the level of discourse, however, should not be confused with convergence of actual tax policies in the member states.

THE ARGUMENT

After a lengthy period of neglect and political stalemate, the European Union (EU) is now making progress in direct tax policy. Indeed, the initiatives against harmful tax competition have now become a cornerstone of the EU policy for the single market. This article raises the question of whether recent developments in EU direct tax policy foreshadow changes in the governance architecture of European taxation. Specifically, it benchmarks innovation in policy instruments (where member states are experimenting with a non-binding code of conduct on business taxation) with the innovations introduced by the open method of coordination (OMC). The latter was defined by the Lisbon Council of March 2000 (although prototypes of this method appeared earlier see Wincott in this volume) and aired in the White Paper on Governance of the European Commission (European Commission 2001a) in the context of the changing governance architecture of the Union.

The OMC is – according to the Lisbon Council – a means of spreading best practice and achieving convergence towards the EU goals. The idea is to use the EU as a transfer platform rather than as a law-making system. Thus, the

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OMC should assist member states in developing their own policies. The 'method' is defined by the following characteristics: EU guidelines combined with specific timetables; action to be undertaken at the national and regional level; benchmarking and sharing of best practice; qualitative and, when appropriate, quantitative indicators; 'period monitoring, evaluation, and peer review organised as mutual learning processes' (Presidency Conclusions, Lisbon European Council, 23–24 March 2000).

Soft law has been around EU policy for some time, as shown by the work of Snyder (1994; see also Abbott and Snidal 2000 on the political logic of soft law). Almost invariably, soft law is used in the EU where the lack of political consensus blocks the road to traditional law-making processes. The relationship between the OMC and hard law varies. Indeed, there are areas where the OMC is used in the presence of hard law, areas such as social policy and migration, for example. But even in these areas, political confrontation limits the development of hard law competence. In other areas, such as pensions, the OMC is not accompanied by the hard law competence of the EU. Finally, there are areas where there is some degree of hard law competence, such as education and health, but the treaties strictly limit the boundaries of this competence. Accordingly, one question for this present article is what is the relationship between soft law and hard law in taxation?

Scholars looking at the OMC as emerging governance architecture (de la Porte and Pochet 2002; Trubek and Mosher 2001; Bertozzi and Bonoli 2002) stress its potential for policy learning, participatory governance, and 'better regulation'. Given that one aim of this article is to benchmark innovation in tax policy with the OMC, it is important to clarify what type of OMC provides the yardstick. The claims about learning, participatory governance and better regulation are applicable to the most sophisticated forms of OMC, such as the European employment strategy. Policy-makers are also experimenting with the OMC in other policy areas (social inclusion, pensions, education and training, migration, research and development, enterprise policy and macro-economic policy, for example): the degree to which governance is 'socially participative' varies to a large extent in these areas, from a minimum in the broad economic policy guidelines to a maximum in social inclusion. In the remainder of this article I will refer to these three properties (that is, learning, participation and better regulation) of the OMC as governance architecture, but with the qualification that the benchmark is the most sophisticated type of OMC we know of – a type that comes close to the practice in employment policy (see Daniel Wincott's article in this issue for a discussion of the different types of open coordination).

Let us consider the three properties. To begin with, the OMC is iterative: in the European employment strategy, benchmarking and guidelines at the EU level inform national action plans; the results of plans are then peer-reviewed with the aim of recalibrating EU guidelines. It is also geared toward a governance architecture which brings society back into the EU

policy process: in the case of employment policy, the OMC is expected to foster wide-ranging consultation and to encourage the participation of social partners in the making of EU policy. Another point on the OMC potential in terms of 'better policy' stems from the debate on the future of EU regulation (European Commission 2002). Indeed, being based on soft law and the inclusion of social actors, the 'method' provides an alternative to traditional 'command and control' regulation. As such, the OMC is expected to deliver 'better regulation'.

This article addresses the following issues: to what extent does the code of conduct on business taxation follow the template of the OMC? Is a 'new governance architecture' – based on learning processes and the inclusion of social actors – emerging in EU tax policy? What are the results achieved by the code? One argument in this article is that the tax code is consistent with the basic features of the OMC. As the code was agreed well before the Lisbon Council and no reference to the OMC was made by the Council's Group working on the code, one can talk of an open method of coordination in disguise. However, it will be shown that the political logic of the tax code is not entirely similar to the logic of the OMC. For example, the aims of integrating social actors or finding alternatives to 'command and control' regulation are not prominent in the code. Let us start with the aim of switching from traditional to 'better' regulation. The logic of the code is one of political necessity in an area where it has been extremely difficult to develop EU regulation. Put differently, the code was not drafted in order to improve on traditional, rigid EU law and deliver more flexible regulation. Indeed, there is no 'regulatory system' for EU taxation; there exists only embryonic regulation of certain aspects of business taxation. Turning to participatory governance, the business community and non-governmental actors have so far remained outsiders in the deliberations concerning the code. Yet an increasing number of employers' federations, think tanks, and social movements have made proposals concerning international business taxation – see Ceps (2000; 2001); the initiatives of Attac (at <http://www.attac.org/indexfla.htm>) and 'The Tobin Tax Initiative' (at <http://www.ceedweb.org/iirp/>). Hence, the potential of the code as new governance architecture should not be exaggerated.

Another argument presented here is that the code is embedded in a wider context and therefore cannot be assessed without a consideration of other interdependent initiatives to crack down on harmful tax competition. The future of soft new policy instruments in EU tax policy is therefore contingent on the progress made in the traditional law-making process. Soft and hard law remain intertwined. This makes taxation similar to those policies wherein the OMC has emerged in conjunction with traditional approaches to policy-making.

Having said that, the major result achieved by the code is convergence of EU tax policy-makers around a community of discourse, some tax policy beliefs, and a limited number of decisions. Following Brunsson (1989) and,

more recently, Pollitt (2001), I will distinguish between convergence in debate, convergence in decisions, convergence in actual practice and convergence in results. EU finance ministers share the same beliefs about the damages of harmful tax competition (although some countries have stronger faith in these beliefs than others). They are also able to take some decisions on what should be done (although some governments are reluctant to agree). However, convergence does not mean that actual national tax practice has changed dramatically: at best, empirical evidence shows that member states share more information than in the past and have not introduced aggressive tax schemes. It is too early to say whether convergence of tax policy beliefs has produced domestic policy change.

The article is organized as follows. The section that follows presents the historical context and illustrates how the current EU tax policy emerged in the second half of the 1990s. This is followed by a section which provides a discussion of the political aspects of the code of conduct, a section which illustrates the link between the code and other tax initiatives and a section which discusses what has been achieved so far. Specifically, this section raises the question of whether ideational convergence (the main result achieved by the code) has also produced policy change. The final section presents the conclusions.

THE CONTEXT

The task of developing direct tax policy in the EU has always been a difficult one. Additionally, there is a *prima facie* argument that this policy area is not amenable to the OMC. This is due to several reasons. First, both sovereignty and legal arguments – unanimity and the lack of a specific treaty base for direct taxation (in contrast with the relatively precise articles of the Treaty of Rome on indirect taxation) – produce a very narrow path for direct tax proposals. For example, the idea of the peer review of domestic tax systems (peer review being a cornerstone of the OMC) was considered political anathema by several governments up until recently.

Second, although proposals for direct tax coordination have been aired since the 1960s, there is disagreement about the content of a Community policy in this area. It is difficult to see the end result of tax policy coordination. Contrast this with the situation relating to the euro, where a simple concept (that is, one single currency for the EU) can be relatively easily grasped by both politicians and citizens. But the question of ‘what could a possible fiscal system for the EU look like?’ does not lead to simple answers. The OMC implies that the main EU policy goals have been set. Indeed, the method stipulates that convergence should be ‘towards the main EU goals’ (Lisbon conclusions, p. 12, para. 37). If the content of fundamental EU tax goals cannot be specified, convergence becomes an elusive notion.

The problem is compounded by the lack of desirable models to be imitated and diffused throughout the Union. Disagreement on what is good or best practice in terms of tax policy is yet another hurdle that has historically

hindered progress. There is a fine line between 'acceptable' and 'harmful' tax competition. To what extent would a notion of 'good tax practice' cover tax regimes designed to poach the tax base of other countries? Even at the scholarly level (not to mention the political level) different schools of thought (specifically, public choice and public finance, see Frey and Eichenberger 1996) go in different directions. Public choice finds very little harmful in tax competition because it magnifies the political distortion induced by the state acting as Leviathan. Hence tax competition is necessary to tame the Leviathan. Public finance is more concerned about the economic distortions caused by the differential treatment of domestic and foreign capital. Consequently, this school has a higher propensity to identify instances of harmful tax competition (and here it should be mentioned that Edward and Keen 1996 provide useful suggestions to bridge the gap between the two schools).

Thus, not only is the political and strategic context an extremely daunting one for the adoption of the OMC (lack of best practice, sovereignty as an obstacle to peer review, and no Economic and Monetary Union-like timetables for convergence around a clearly specified 'final system'), it is challenging for the formulation of EU direct tax policy *tout court*. How has the Commission responded to this challenge? It is useful to situate the code in its historical context. What other techniques of coordination were used before the code was introduced? What type of learning process has led to the shift to soft law?

Up until the mid-1990s, the Commission tried to overcome the hurdles described above by making reference to the single market. The Commission, the business community, and economists argued that the efficiency of the single market required tax neutrality on international business operations (European Commission 1990; Devereux and Pearson 1989). Companies were well represented in a high-level committee set up by the Commission (the so-called Ruding Committee, European Commission 1992) with the aim of proposing a blueprint for the future of EU business taxation. At that time, the Commission proposed directives, although, at least in one case (European Commission recommendation on the taxation of non-residents, 21 December 1993), Brussels opted for a recommendation to member states. Overall, the focus was on traditional policy instruments.

The result of this strategy was poor. Two directives were approved in 1990. In the same meeting, the Council also approved a convention (instead of the directive the Commission had originally suggested) on arbitration in transfer pricing disputes (for details, see Radaelli 1997). But nothing else happened. The proposals for tax directives gathered dust on the shelves or were withdrawn by the Commission. No peer review of domestic tax systems took place. More generally, the Council did not pay political attention to the proposals of the Commission. The idea of eliminating distorting taxes – whatever the technical appeal of the argument might have been – was not very attractive to ministers of finance.

Since 1996 the Commission has changed its strategy to overcome the obstacles to tax coordination. The new strategy is based on the necessity to crack down on harmful tax competition. This chimes with the long-term interest of revenue authorities, that is, to guard the revenue base. The response of member states to this was more positive than in the past. Political determination to curb certain forms of tax competition was achieved. Once the ball started rolling, the problem became to select the policy instruments suitable to the new tasks. The Commission, the European Parliament and some delegations came up with some initial thoughts on a directive on company taxation, combined with a directive on the minimum taxation of savings in the Community.

Even in the case of Luxembourg, not-so-keen on tax coordination, there would have been a preference for a directive on company taxation rather than a non-binding instrument. But the explanation of this preference for a directive has something to do with the position of this country in the global competition for capital. Ireland and Belgium, for example, are very attractive locations for foreign companies. They were the natural targets of a possible directive against harmful tax competition in company taxation. By contrast, Luxembourg has specialized in attracting savings. In other words, Ireland and Belgium are very competitive in corporate taxation whereas Luxembourg is more competitive in attracting portfolio income. Hence the position of Luxembourg, which saw the proposal for a directive on business taxation as the natural counterbalance to the losses to be incurred as a result of a directive on saving taxation.

Thus, at the beginning of the new anti-harmful tax competition crusade (1996–97), there was no deliberate intention to introduce new policy instruments. The debate on taxation was not focused on the merits of non-binding instruments as an alternative to traditional regulation. Neither was the debate focused on the necessity to find more flexible instruments in a policy area suffocated by too many rigid directives. As mentioned above, the legal framework of EU direct taxation remained incomplete, indeed no more than embryonic (Farmer and Lyal 1994). In terms of actors, there was no discussion about bringing the social actors back into the tax policy process. One possible reason for the failure of the Ruding Committee's proposals was that the Committee reflected the interests of business and did not pay enough attention to the problems faced by finance ministers. All in all, this makes the political logic of the code different from some of the characteristics of the OMC.

Innovation in tax policy instruments emerged as a *political expedient* when it became clear that agreement on a business tax directive was impossible to achieve. Necessity – rather than a reorientation of regulatory approaches – led the Council towards the code of conduct. The Council dropped the idea of a directive on company taxation and resolved the conflicts in a deal struck in December 1997. The ECOFIN Council agreement (OJ C 2, 6.1.1998) is based on a three-piece tax package and a fourth element concerning fiscal state aid. The tax package includes the code of conduct, a proposal for

a directive on the minimum taxation of EU non-residents, and a proposal for a directive against the double taxation of multinationals. These three elements are formally bundled, which means that disagreement on one element makes agreement on the other two elements impossible. Let us now take a look at what is in the package.

THE POLITICS OF NEW POLICY INSTRUMENTS

The first element of the 1997 agreement is a voluntary code of conduct on business taxation (discussed further below). The second component of the deal is the commitment to ensure a minimum of effective taxation of savings within the Community. In 1997, the Council requested the Commission to come up with a proposal for a directive and set out a few points around which the proposal should be fleshed out. Following this invitation, in May 1998, the Commission presented a proposal for an exchange of information or a 20 per cent withholding tax on interests paid to non-resident EU citizens. This is the proposal that raised many objections in the City of London, worried by the possibility that capital markets would react negatively to the European tax on savings and migrate elsewhere (Baron 1999). Further to an unsuccessful attempt to mitigate the worries of the British delegation in Helsinki (December 1999), the EU debate has veered towards exchange of information as the best option. This would mean the abolition of bank secrecy for EU non-residents. The Feira EU summit (20 June 2000) recognized the possibility of opting for the coexistence model (that is, withholding tax or exchange of information) for a limited period of seven years, after which all countries would run a regime of automatic exchange of information among tax authorities. As will be shown below, in 2003 three countries were given the possibility of retaining bank secrecy indefinitely (provided that they apply high withholding taxes) thus questioning the value of the EU commitment towards full exchange of information.

At Feira, the EU leaders dropped the May 1998 proposal for the taxation of savings, but set the coordinates for a new one. The new proposal was finalized by the Commission in July 2001: 'Proposal for a Council directive to ensure effective taxation of savings income in the form of interest payments within the Community', COM (2001) 400 Brussels, 18/07/2001. There was agreement on a process leading to the approval (unanimity voting applies) of a three-piece package (a directive on the taxation of EU non-residents' savings, a directive on interest and royalties, and the full implementation of the code of conduct) by 'no later than 31 December 2002' (this deadline was not met, see below) provided that (in the area of the taxation of savings) 'third countries' (Switzerland, Liechtenstein, Monaco, Andorra and San Marino) implement 'equivalent' measures and that the dependent or associated territories of EU countries (the Channel Islands, the Isle of Man, and the territories in the Caribbean) enact the same measures as the EU member states. According to the Feira timetable, in 2009, all member states would switch to exchange of information as the rule for the taxation of EU non-residents' savings.

The Feira European Council endorsed only a timetable, but, in doing so, it generated momentum for tax coordination. It also established the principle that exchange of information (rather than withholding taxes on non-residents' savings) become the main target of the EU. Another important step was taken at the ECOFIN Council meeting of 27 November 2000, when the French Presidency secured an interim deal for those countries which – within the time limitations set at Feira – want to use withholding taxes rather than exchange of information. Austria, Belgium and Luxembourg were allowed to levy a withholding tax at 15 per cent for three years – and then 20 per cent until 2009. A regime for the so-called 'grandfathering' of Eurobonds was also agreed.

The EU Ministers did not manage to meet the December 2002 deadline, although Austria, Belgium and Luxembourg were given the option of avoiding exchange of information until 2011. On 21 January 2003, however, the Greek presidency of the EU announced that ECOFIN had achieved a breakthrough. The Greek presidency compromise contained the commitment to agree on the tax package in March 2003, provided that the EU, on the basis of unanimity, signed an agreement with Switzerland on withholding taxes on EU residents' savings. The idea was that Switzerland would apply the same rates as Austria, Belgium and Luxembourg, that is, 15 per cent between 2004 and 2007, 20 per cent from 1 January 2007 and 35 per cent from 1 January 2010. The important point is that, although ECOFIN reaffirmed the preference for exchange of information, three countries were effectively given an opt-out – as the obligation to switch to exchange of information in 2011 was dropped. Although many observers judged the compromise to be of poor quality (the *Financial Times* called it 'squalid' – 17 January 2003), everything was ready for a final agreement in March 2003. But on the 19 March 2003 ECOFIN and the European Council which followed on 21 March, it was impossible to reach agreement because the Italians linked the approval of the tax package to their request for special terms for the payment of fines related to the overproduction of milk. The new Italian requests derailed (and soured) the EU train when the final stop was only one mile ahead. Further to a final round of negotiations on the Italian demands at the level of COREPER, the ECOFIN Council eventually agreed on the tax package on 3 June 2003.

The third element involves the proposal for a directive on cross-border payments of interests and royalties mentioned above. This is a typical single-market measure. Conceptually, it has nothing to do with the EU fight against harmful tax competition. As such, the proposal should have been approved a long time ago.

The final element concerns fiscal aids. This is an element of the 1997 agreement, although technically it falls outside the tax package. What is the reason behind the inclusion of state aid in the 1997 agreement? Simply put, special tax regimes have too often been built under the rubric of legitimate state aid policy, thus avoiding the scrutiny of the tax Directorate of the Commission.

The essential point here is the connection between tax policy and state aid policy. In a press release on 23 February 2000, Commissioner Mario Monti stated that the Directorate General for competition 'will examine all the relevant cases of fiscal state aids in business taxation, so as to allow the Commission to comply fully and promptly with its own institutional obligations'. The connection between state aids and taxation requires an examination of the progress made in the code of conduct. It is to the code that we now turn.

The code of conduct defines harmful tax competition. It covers the fifteen countries of the EU and – the point is extremely sensitive in tax policy – their dependent territories. Dependent territories are subject both to the regime of the code and to the provisions for the taxation of savings. Indeed, one controversial point in the Greek compromise of January 2003 is that dependent territories have to give up bank secrecy whereas three EU member states can keep it. Candidate countries were asked to endorse the principles of the code as part of the negotiations on EU enlargement. The code – as defined by the 1997 Council agreement – includes general provisions for standstill and rollback of harmful tax regimes according to a five-year timetable. Rollback can take two forms: (1) elimination of the tax measure; or (2) elimination of the harmful components within the tax regimes while at the same time not suppressing the regime itself. The Council may decide to extend some harmful tax measures beyond December 2005, but the rule is that the harmful components of domestic tax policy should disappear by then.

As argued above, the choice of a voluntary code was the result of political necessity. Most governments felt that a directive would erode political sovereignty and would be too difficult to manage. By contrast, the notion of a non-binding instrument hinging exclusively on political determination calmed political apprehension.

When the code was introduced, the then Commissioner for the single market and tax policy did not start any comprehensive review of non-binding instruments in EU policy. Although at that time non-binding instruments were already in use in other policy areas, the Commissioner felt that there was neither time nor staff available for an inquiry on what these instruments could achieve and their transferability to tax policy. Neither was the discussion on the code linked to the emerging debate on the OMC in the years preceding the Lisbon summit. Consequently, the problem of how to make the code work was very much a learning by doing exercise for the Commission and the member states.

A Council group (the Primarolo Group, named after its chair, the British Paymaster General MP, Dawn Primarolo) was established to manage the code. The challenges for this group were formidable. To begin with, there was the problem of experimenting with the first example of soft law in corporate taxation. The other challenge was political. For the first time in history, 15 high-level tax policy-makers were sitting with the Commission around a table to undertake a peer-review of potentially harmful tax measures. To see an Irish delegate commenting on the potential harm created by the Belgian

coordination centres was a sea change in the tax history of the EU. It has to be said also that it was a bit of a political mystery how to find agreement by dint of peer review in sensitive areas such as special tax regimes for foreign multinationals, the tax systems of the Channel Islands and the legislation of the Trieste (Italy) financial services and insurance centre.

The third challenge was cognitive. The 1997 agreement defines harmful tax competition in general terms. It also provides a list of criteria to define the harmful characteristics of tax competition (see box 1). Note that there is no scientific consensus on the theoretical definition of harmful tax competition (see the section on context, above) and that even the empirical evidence is somewhat disputed by both economists and political scientists (Basinger and Hallerberg 2000; Ceps 2000; Dehejia and Genschel 1999; Gordon and Bovenberg 1996; Swank 1998). The criteria identified by the Council do not derive from a list on which a representative panel of economists would agree. Some economists might agree, but others would simply argue that there is tax competition, but it is nonsense to discriminate between harmful and non-harmful competition (see Devereux's statement in House of Lords 1999).

BOX 1 *How the code of conduct defines harmful tax competition*

- A. Without prejudice to the respective spheres of competence of the Member States and the Community, this code of conduct, which covers business taxation, concerns those measures which affect, or may affect, in a significant way the location of business activity in the Community. Business activity in this respect also includes all activities carried out within a group of companies. The tax measures covered by the code include both laws or regulations and administrative practices.
- B. Within the scope specified in Paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code. Such a level of taxation may operate by virtue of the nominal tax rate, the tax base or any other relevant factor.

When assessing whether such measures are harmful, account should be taken of, *inter alia*:

- (1) whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents, or
- (2) whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base, or
- (3) whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages, or
- (4) whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD, or
- (5) whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way.

Source: Official Journal C 2, 6.1.1998.

The agreement on the code's criteria – in a situation where economics does not provide single answers to specific problems – is therefore a remarkable

achievement. The criteria provided the fundamental concepts around which a community of discourse was able to emerge. Tax policy-makers have now found a vocabulary that describes reality. The creation of a community of discourse is an indicator of convergence in 'talk' (Pollitt 2001). In this case at least, it also implies shared tax policy beliefs and norms about 'good' and 'bad' tax competition. Peer review has now become a standard method in the making of EU corporate tax policy. Argument, mutual adjustment and persuasion have a fundamental role to play in peer review. However, following Brunsson (1989), one should not assume that people or organizations belonging to the same community of discourse take the same decisions. Convergence in 'talk' may not produce convergence in decisions. Neither does it produce the same actions: even if a decision is taken, implementation may differ. Pollitt (2001, p. 940) adds that even when there is convergence in action the actual results may differ: 'even determined implementation (actions) does not necessarily lead to uniform or expected results'.

Was the tax community of discourse able to produce convergence in decisions then? Can abstract criteria work in decisions covering specific tax regimes? The Primarolo group set out to produce convergence on the practical meaning of the criteria. In addition, the code asks member states to commit themselves to re-examining existing tax laws and established practices 'having regard to the principles underlying the code' (par.D of the code) and to 'inform each other of existing and proposed tax measures which may fall within the scope of the code' (par.E of the code). Has all this happened? In order to address this question, we now turn to empirical evidence on how the Primarolo Group managed the code.

The Primarolo group worked on a long list of 271 potentially harmful tax measures in member states and dependent territories. After a series of meetings and peer review sessions, the group reported on the implementation of the code to the Council on 29 November 1999 (document SN 4901/99). The Helsinki summit (December 1999), however, was unable to examine and endorse the Primarolo report. The important political point is that while the *criteria* listed in the Code of Conduct were discussed and formally agreed by all Member States on 1 December 1997, the 1999 Group's *report* was not, although a few months after Helsinki it was made public on the EU web site. The report shows that some delegations entered reservations to the decisions of the Group on specific tax regimes. Whenever Council documents refer to the 'code of conduct group's deliberations', they indeed refer to broad consensus but not necessarily to unanimity. The ECOFIN conclusions of 9 March 1998 state that the reports of the code of conduct group can reflect either the unanimous opinion of the members of the group or the various opinions, not necessarily unanimous, expressed in the course of the discussion. This is an objective limitation to how far the Group can go in terms of pressing for convergence in decisions (at the level of the Group) and action (at the level of changes in national tax laws).

However, the Group was able to produce agreement on the decision to list 66 (out of 271) measures as harmful. This is evidence that at least some convergence in decisions occurred. Further to the publication of the report, the Group met quite regularly. It achieved consensus on the principles of standstill and rollback. This is yet another example of convergence of 'talk' (definition of principles). But the link between discourse and actions at the national level (note that standstill and rollback have to take place at the level of member states) is fragile. This is demonstrated by a progress report presented to the Council in November 2000, in which all delegations agreed on the principles of standstill and rollback, but one delegation objected to the specific criteria used to implement the principles. At every meeting of the Group there is some area of agreement, but if one scratches below the surface one finds that there are at least two or three views on what the real implications of the agreement are.

AN INSTRUMENT EMBEDDED IN A WIDER CONTEXT

Before we turn to an assessment of the code, it is useful to observe that this instrument is embedded in other political initiatives against harmful tax competition. In terms of policy dynamics, the future of the code – to use a metaphor – overlaps with three circles. The circle which is most immediate to the code is that of the tax policy package. The 3 June 2003 agreement on the tax package bodes well for the future of the code. However, the implementation of the directive may encounter problems due to the special exception on bank secrecy granted to three member states, the difficulty of getting to a manageable agreement with Switzerland, or the reluctance of new EU member states (Estonia, Lithuania, Malta and Slovenia asked for a transitional period on their obligation to implement the directive on savings). The code is politically sensitive to what happens to the directive on savings when it hits the road of transposition. Consequently, the autonomy (in terms of what can be achieved autonomously by the instrument) of the code is constrained. Put differently, if the old-style directive on savings does not work, the non-binding instrument will not go far.

There is a second policy circle (that is, fiscal aids) which overlaps with the code. This is not a matter of concentric circles, but one of political interplay. As noted above, the Council gave a broad mandate to the Commission (in December 1997) to re-assess those fiscal aids possibly in breach of the fair tax competition paradigm outlined in the code. There is a big difference between a non-binding instrument, the code of conduct, and state aids, where the Commission has considerable power. However, politically the arenas of the code and state aids are connected.

The Commission gains considerable leverage from these nested arenas. When the decisional speed in the code of conduct arena decreases (because governments disagree on how to make progress with the implementation of certain steps), the Commission gets ready for action in terms of competition policy. When the process in the area of the code (and more generally the tax

package) re-starts, DG Competition seems inclined to adopt a prudent wait and see policy. For example, during Autumn 2000, when the chances of making progress on the code and the tax package appeared low, the EU Commissioner for competition policy loaded the gun by starting preliminary investigations on selected fiscal aids. Formal state aid procedures were not open, however, to keep pressure on the national delegations negotiating in the code arena. The gun was loaded, but the trigger was not pulled. Soon afterwards an agreement on the tax package was achieved (on 27 November 2000) and DG Competition manifested no intention to open formal procedures against the fiscal aids object of the preliminary investigation. Clearly, this is a political mechanism of threats, sanctions and rewards. Member states are rewarded for their 'good behaviour' at the code of conduct table by putting a hold on state aid procedures. To summarize this point, the link between state aids and the code advantages the Commission by giving it some political leverage in terms of threats, rewards and sanctions.

The third policy circle lies outside the EU. It refers to the OECD forum against harmful tax practices (OECD 1988). Although the EU code of conduct and the OECD initiative against harmful tax practices share different goals and cover different types of economic activity (see the analysis contained in Ceps 2000), *politically* the EU policy against harmful tax competition benefits from a similar orientation at the OECD level. Further to the OECD report on harmful tax competition (1998) – which contained 19 detailed recommendations to combat unfair tax practices both within the OECD and in tax havens outside the organization – a second report was published in June 2000 (OECD 2000). This report identifies 47 tax regimes in OECD countries which are 'potentially harmful'. Unsurprisingly, the list includes the Belgian coordination centres and the Irish international financial service centres. The significant point is that the determination of governments to rollback the harmful measures identified by the Primarolo Group can be increased to a great extent by the acknowledgement at the OECD table that those measures contradict OECD good tax practice. If the OECD project flops, there will be yet another reason in national capitals to show less enthusiasm in complying with the recommendations of the Group. Overall, the OECD table represents an additional element of potential peer pressure. However, the compromise on the taxation of savings achieved by the Greek Presidency of the EU was not well received in OECD quarters. If the EU allows three member states to carry on with bank secrecy, the OECD fight for exchange of information in all jurisdictions (OECD members and tax havens) is objectively weakened.

WHAT HAS BEEN ACHIEVED? IDEATIONAL CONVERGENCE AND POLICY CHANGE

The 'ideational dimension' of politics includes two activities, that is, making sense of reality and 'the ability of actors to judge on the basis of values and norms' (Braun 1999, p. 13). Cognition provides causal beliefs, that is, mental

models that allow policy-makers to see what 'is'. When beliefs are integrated, one can speak of a belief system. Belief systems are socially constructed (Braun 1999, p. 14). Values and norms allow policy-makers to distinguish between what is 'good' and 'bad' and to guide action.

The main achievements of the code refer to the ideational dimension of politics. There are four main points describing achievements in the ideational domain:

1. In terms of sense-making activity, shared beliefs on harmful tax competition provide a system to tackle fundamental issues in EU taxation. This convergence is remarkable because the creation of mental models has not been assisted by epistemic communities. By and large, economists disagree on whether one can really set a boundary between 'good' and 'bad' tax competition. Divergence in the social sciences has not hindered convergence among tax policy-makers, however.
2. Social interaction within the Primarolo group has been intense. The method of peer review is an innovation for tax policy. This is an important result, although – as observed above – there is still disagreement on how to implement certain elements of the 1999 report of the Primarolo Group. The code has been 'a very successful laboratory for trust and mutual understanding' – as one Council officer put it in an interview.
3. The notion of harmful tax competition implies judgement and evaluation. The criteria contained in the code of conduct make evaluation of specific tax regimes possible in the EU context.
4. The social construction of principles and norms is an important aspect of the process. Socialization, interaction, and partisan mutual adjustment have enabled to discover the direction and content of EU policy in this sensitive area. 'We did not know how far we could get when we met the first time: we were about to experiment with the boundaries of what is politically feasible' – said one officer representing the Commission at the table of the Primarolo group.

The empirical evidence presented here shows that a community of discourse has emerged. Interestingly, authors working on the OMC in other policy areas (such as employment) conclude that so far the major impact of the method on domestic policy-makers is 'on the level of ideas' (Bertozzi and Bonoli 2002). Convergence in concepts, beliefs and norms is an important element of OMC politics. But – Brunsson and Pollitt would add – this is just convergence in 'talk'. What about convergence in decisions, convergence in actual practice, and convergence in results? It is to this question that we now turn. There is empirical evidence of consensus at the EU level of major tax decisions such as the agreement found on the list of harmful measures. But the fact that the report of the Primarolo Group (November 2000) was not endorsed by the Helsinki Council (December 2000) limits the range of convergence at the level of decisions. Of course, a fundamental element of convergence in EU decisions was the June 2003 agreement on the tax package.

Has ideational convergence at the EU level produced policy change in the sense of 'convergence in *domestic* actions' (Brunsson 1989) then? It is too early to provide an answer to this question.

Although the Primarolo Group has been able to meet regularly and to take decisions, the political determination to rollback harmful tax regimes may vanish in the future. Being a non-binding measure, no legal action can be taken against a country unwilling to scrap its own tax regimes. In this connection, changes in governments may also represent a problem for the code, although up until now, following national elections, there has been no policy U-turn on the code. Another element of uncertainty is that five controversial regimes (co-ordination centres in Belgium, foreign income regime in Ireland, holding companies in Luxembourg, international financing tax rules in The Netherlands and Madeira's free economic zone) were given an extension to 31 December 2010 – in the context of the Greek presidency compromise of 21 January 2003.

There is evidence that, notwithstanding this state of uncertainty, the code is already generating some changes. For example, recent changes in The Netherlands' intermediate royalty and interest companies, advance pricing agreements and advance ruling practices have been linked to the intention of the Dutch government to comply with the criteria listed by the code (*World Tax Digest* 91–2, 8 May 2001; on intermediary companies see *Tax Notes International*, 23 April 2001). Should further evidence point in this direction, one could well conclude that the code has acquired a life of its own – that is, the power to create domestic policy change independently of the approval of the whole tax package. At the moment, however, to speak of 'convergence in domestic-level action' would be premature.

Rollback is the real acid test of the code. However, progress has already been made in other areas such as notification. Governments have been willing to submit proposals for new tax policy regimes. This has increased the transparency and the commitment to peer review. It would be politically difficult now to propose the same type of beggar-thy-neighbour regimes which were so popular up until the mid-1990s. This is evidence that the policy beliefs enshrined in the code are not irrelevant. Of course, this is not the end of tax competition. One type of competition may be less popular than in the past, but governments may turn to other types of competition. And it remains to be seen whether competition that is limited to a handful of special tax regimes (this is the type covered by the code) is less harmful than 'across-the-board' tax competition (this point is explored by Keen 1999). Therefore, the question of 'convergence in actual results' cannot be addressed at this stage. There is still considerable uncertainty on whether the European tax systems will converge or diverge.

CONCLUSIONS

The code of conduct on business taxation fits in rather well with some characteristics of the OMC. Voluntary agreement, peer review and

timetables make the code consistent with the thrust of the method. Turning to best practice, at first glance it seems that the code has nothing to say on this component of the OMC. The criteria identified by the code do not define best practice directly. Best practice works well for problems (such as employment) that all member states face at the national level whereas tax competition is a problem among member states. However, by highlighting the harmful dimension of tax competition, the code shows indirectly what good tax practice is. Good tax practice does not make sense in EU tax policy – as argued at the beginning of this article, there is no idea of what the ‘best’ fiscal system should be. To determine ‘worst’ practice is therefore the closest EU business tax policy can get to the OMC emphasis on best practice. On balance, the code can be considered to be an example of the method, although EU tax policy-makers have not mentioned this connection. In a sense, it is an instance of OMC in disguise.

Turning to the wider issue of the OMC as emerging governance architecture, what is the political logic of the code? Does the code aim at bringing society back into the tax policy process? Does it provide ‘better regulation’ in the sense of being an alternative to traditional regulation? Is it a platform for ‘mutual learning processes’, to paraphrase the conclusions of the Lisbon summit?

So far the business community has been excluded from the deliberations of the Group in charge of the code. There have been several complaints on this count from employers’ confederations and think tanks. The code was managed in effect in secret, without involving social actors (Ceps 2001). Neither were national parliaments involved. In 1999, some parliaments debated the issue of harmful tax competition (French Senate 1999; House of Commons Hansard Debates 5 July 1999) without having access to the results of the Primarolo Group. In London, at the House of Commons, two MPs expressed their disappointment thus:

Is it not an insult to democracy and to all that we are meant to stand for that the government are agreeing to measures in so-called tax loopholes without the House of Commons or the people being told? (Sir Teddy Taylor)

The House deserves to know what tax measures are being discussed elsewhere, as it practically came into existence to take the means of taxation away from the Crown or the Executive and put it in the hands of those who are answerable to the electorate. (Mr Heathcote-Amory)
[Source: House of Commons Hansard Debates 5 July 1999]

According to some politicians, secrecy has made the code ‘nothing but a PR disaster’ (Lord Desai, see House of Lords, 1999, p. 163). The conclusion is that the code does not score well in terms of transparency, inclusion of social actors and perhaps even legitimacy – three key aims of the most sophisticated forms of OMC. The code is more the response to the problem

of calming political apprehension over EU tax coordination than a way of bringing society back into the EU policy process. The political cost of preserving consensus among member states may have been high in terms of legitimacy. Recent proposals of the Commission (2001b) target the tax problems of multinationals: this may be a political counterbalance to the emphasis on the problems of governments that has characterized the code.

What about the code as an alternative to traditional regulatory approaches? The tax code has not been designed to make regulation more flexible. It did not emerge in the wake of dissatisfaction with a large body of 'rigid' regulatory directives. It was not devised as a change towards 'better regulation' as defined by the Commission in its annual reports on this topic. For the reasons explained above, the code emerged as a political expedient.

The code does not operate in the shadow of a relatively mature body of EU tax legislation. It works however in the shadow of other tax policy initiatives, both at the EU and the OECD levels. It cannot be assessed on its own merits. Thus, the future of the OMC in direct tax policy hinges on the progress of more traditional instruments of tax policy and also in part on the achievements of the OECD campaign.

Finally, the results in terms of convergence of policy-makers are striking and at the same time limited. They are striking because for the first time in history finance ministers share a common definition of what the main EU tax problem is (that is, harmful tax competition), use the same vocabulary and concepts to make sense of reality, share criteria and norms to peer review their potentially damaging tax regimes, look at tax policy in terms of interdependence and accept commitments for standstill and rollback. Of course, these beliefs and commitments are better grounded in the tax culture of certain countries than in others, as shown by some perplexities in Britain, Luxembourg and The Netherlands. But all fifteen countries have so far shared the approach as well as the most important implications of the campaign against harmful tax competition. The Primarolo Group has been a platform for socialization and ideational convergence. Convergence remains limited, however. There is more convergence in 'talk' and (to some extent) EU-level decisions than in domestic implementation and policy results. The governance architecture of EU taxation, then, remains fragile and uncertain in terms of what it can deliver.

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