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## GLOBALISATION, HARMONISATION – THE IMPACT ON CORPORATE INCOME TAX

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**Summary:** This paper examines the impact of two important ongoing developments: globalization and harmonization. The main conclusions are that: globalization and harmonisation have the potential to raise economic growth and improve the overall fiscal position, but on the other hand they put pressure on government finances including tax system. Globalization and international factor mobility have implications for efficient taxation of firms and individual taxpayers operating in multiple tax jurisdictions. In such a case we can talk about the impact of globalization in the aspect of tax competition. The question is about harmonization which includes 27 different tax jurisdictions by European Union Directives implementing common market rules.

**Key words:** corporate tax burden, mobility of coporation, race-to-the-bottom, favourable tax regime.

### 1. The aspect of globalization

Without any doubt we live in the globalized world and to keep good competitive position in global economy we have to accept global rules. What does it mean? Globalization can be interpreted in various ways but it means that country's dependence on the rest of the world is very high now. What happens abroad matters and the rest of the world has many ways of intruding in the activities of a country and of its citizens [Tanzi 2004, p. 3-5]. Globalization means unfolding process, centring on production and distribution networks and on financial institutions, products, and transactions and it is having a profound impact on the wide range of policies and practices both in private and public sectors. The current omnipresence of globalization has the source in modern technologies which give a huge facility and rapidity with which information can now be accessed or sent, with the large reduction in the cost of transporting goods, persons and capital, with the progressive transfer of sovereignty – including also tax sovereignty from nations to international organizations and interantional agreements.

According to Lodin, Owens and Tanzi present tax systems evolved when a country formulated its own tax policy and focused on the requirements of its domestic economy. When tax treaties, agreements and conventions among nations

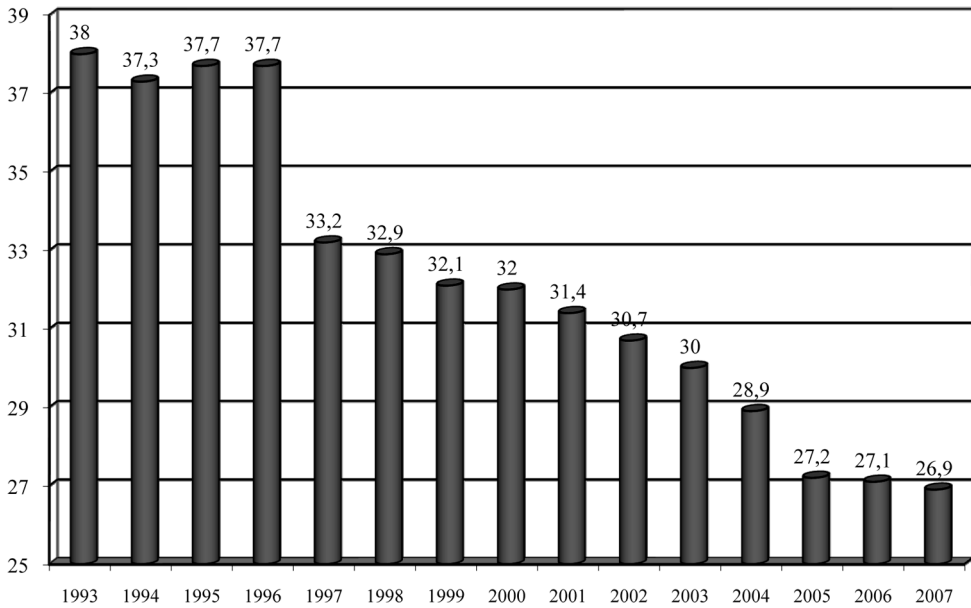
were negotiated, they were within the framework of national sovereignty in tax policy. The globalization process has changed this, particularly with respect to the level of taxation, mix of taxes, design of particular taxes, and the manner of their administration and compliance. It has caused that a country is no longer isolated from the rest of the world. Countries are being forced to exhibit much greater awareness and sensitivity to the tax changes being undertaken by their trading partners and competitors, reducing autonomy concerning their own tax policies [Asher, Rajan 1999, p. 1].

Tanzi identifies eight “fiscal termites”: e-commerce and transactions, use of e-money, intracompany trade, off-shore financial centres and tax heavens, derivatives and hedge funds, inability to tax financial capital, growing foreign activities, and foreign shopping, to depict how globalization and technological changes will impact on national tax systems [Tanzi 2000, p. 4-15]. Domestic policy changes are promoted or even imposed and influenced from outside. In other words, the adaptation of the tax systems to globalization is expected to be slow and subtle rather than discontinuous. It is also possible that even as the tax administrators confront challenges in administering current taxes, new types of taxes may become feasible with the rise of new technologies and activities [Tanzi 2000, p. 4-15].

Taking into account the mobility of some factors (especially capital and labour), very dynamic technological progress and global competition most of the governments try to use fiscal instruments to create very preferential conditions to attract investors and offer them the long list of economic benefits for economy. The government of an open economy can have no interest in increasing tax rates above that of the international equilibrium, for to do so would simply drive away investment, and stimulate a capital flight. As a result, however, the ability of the state to pursue independent economic policies has been greatly compromised, if not destroyed.

Since two decades we have witnessed the process called “race-to-the-bottom” in the tax rates – especially in the field of corporate rates (Figure 1). The great development of modern technology made investment and profits become very responsive to the country tax rates. Some studies found that countries with tax rates that were higher received about 30% less direct investment from the United States [Altshuler, Gruber, Newlon 2001, p. 12].

Ireland in particular attracts a large number of investment and profits because of its low corporate tax rate of 12,5%. In 2004 this small state attracted about 8% of all the profits of US foreign affiliates. According to Sullivan businesses get an initial tax break on their real investment in Ireland, and then they get a second-round break if they shift investments to Ireland through various financial techniques [Sullivan 2007, p. 312]. Sullivan finds also that, at least in the European context, countries with a “favourable tax regime” have “significantly larger inflows of direct investment” than their higher-tax counterparts. Four European countries with particularly “favourable tax regimes” – namely Ireland, the Netherlands, Luxembourg, and Switzerland – attracted 38% of US direct investments to Europe between 1996 and 2000 despite accounting for only 9% of EU GDP.



**Fig. 1.** Declining Corporate Tax Rates in OECD member states

Source: KPMG’s *Corporate Tax Rate Survey. An international analysis of corporate tax rate from 1993-2007*, 2008 [www.kpmg.com](http://www.kpmg.com).

The United States is falling far behind in the global trend of reducing corporate tax rates. This is ironic because the United States used to be a tax reform leader. Under President Ronald Reagan, the federal corporate tax rate was cut from 46% to 34% in 1986, which significantly improved America’s competitive position. United States policy moved to the wrong direction in 1993 when President Bill Clinton pushed the federal corporate rate up to 35% [Mintz 2008]. Every developed state except the United States reduced corporate rates. The average top corporate tax rate in industrialized states fell by nearly 20 percentage points. Most of the European countries have lower corporate rates and generally better corporate tax systems than the United States. A variety of measurements of the corporate tax burden show that the US tax code is hostile to investments. A study by a tax scholar Jack Mintz for Canada’s C.D. Howe Institute compared effective tax rates across a range of countries. Table 1 shows that among advanced economies, US investments faced one of the highest marginal effective tax rate.

Numerous advanced economies have been forced to reduce commercial tax rates in recent years, and in doing so they have pushed the average top corporate tax rate in the OECD down from 38% in 1993 to 25.1% in 2007 (Figure 1). Among them, Austria, Germany and Ireland have cut their rates by more than 25%, while another

**Table 1.** Effective Corporate Tax Rates<sup>1</sup>, 2008

Argentina	46%	Malaysia	18.6%
China	45.3%	Bangladesh	17.8%
Chad	40.1%	Madagascar	17.4%
Brazil	39.1%	Netherlands	16.6%
India	37.6%	Ugandna	16.4%
Korea	37.1%	Vietnam	16.3%
Russia	37.0%	Jamaica	16.2%
France	35.9%	Switzerland	15.5%
Japan	35.0%	Mexico	15.4%
Australia	29.3%	South Africa	15.1%
Canada	29.1%	Ghana	14.8%
Pakistan	28.9%	Trinidad	14.8%
Britain	28.7%	Czech Rep.	14.7%
Italy	28.1%	Maroco	14.5%
Costa Rica	27.8%	Poland	14.0%
Germany	27.3%	Rwanda	13.8%
Indonesia	26.9%	Chile	13.8%
Lesotho	26.5%	Ecuador	13.7%
Spain	26.4%	Hungary	13.5%
Austria	26.4%	Ireland	13.2%
Peru	24.7%	Slovak Rep.	12.6%
Norway	24.5%	Greece	11.9%
Botswana	23.3%	Iceland	10.5%
Tunisia	23.1%	Egypt	10.4%
Tanzania	22.2%	Croatia	9.4%
Ethiopia	21.9%	Romania	9.4%
Bolivia	21.9%	Turkey	9.2%
Sierra Leone	21.9%	Ukraine	8.7%
Sweden	21.1%	Singapore	8.0%
Zambia	20.6%	Mauritius	7.4%
Georgia	20.5%	Hong Kong	4.4%
Kazakhstan	20.4%	Latvia	4.2%

<sup>1</sup> Effective tax rates take into account corporate rate, capital cost recovery, and taxes on capital purchased as retail sales taxes and nonrefundable value-added taxes. Other capital-related taxes are also included, such as taxes on assets, gross receipts taxes, stamp duties, and financial transaction taxes.

Finland	20.1%	Bulgaria	4.1%
New Zealand	20.1%	Nigeria	3.1%
Uzbekistan	20.1%	Kenya	1.8%
Jordan	20.0%	Belgium	-3.4%
Fiji	19.2%	Serbia	-6.0%
Luxembourg	19.1%	Weighted Average	29.6%
Portugal	19.0%	Simple Average	19.5%
Thailand	19.0%		
Denmark	18.6%		

The data include both national and subnational corporate income taxes.

Source: J.M. Mintz, *Cutting the effective corporate tax rate*, “Tax and Budget” October 2008, No. 50.

six countries have cut their rates by more than 15% tightening the tails of the tax range from between 55% and 28% to between 34% and 12.5% in the process.

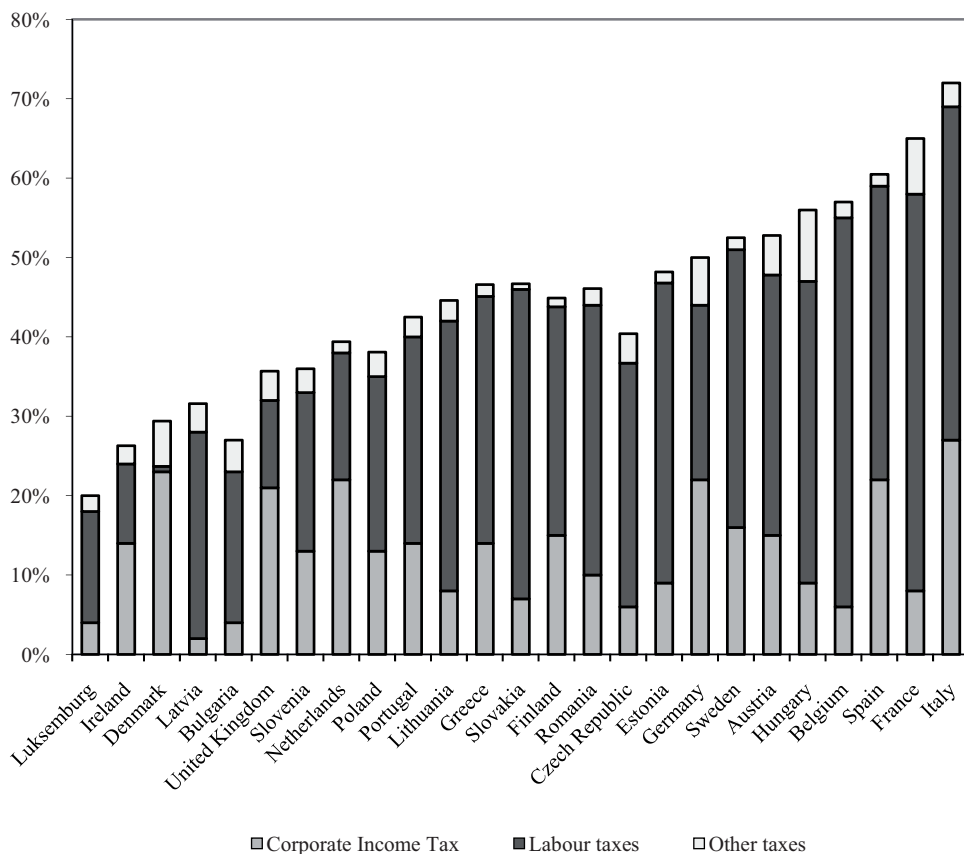
Tax scholars generally agree that taxes drive the decisions of a multinational corporation. US Treasury found that a country with the effective tax rate 1 percent point lower attracts about 3% more capital. Based on this result, a 1 percentage point cut of the effective tax rate on capital will increase a foreign direct investment as a share of gross domestic product by 0,1% [Mintz 2008, p. 2]. We can find a substantial confirmation of it in academic studies. For instance, Hines finds that taxation significantly influences the location of foreign direct investment, corporate borrowing, transfer pricing, dividend and royalty payments, and research and development performance [Hines 1999, p. 128]. Desai concludes that multinational firms are extremely aggressive and sensitive in responding to taxes on the margins of avoidance, ownership, and investment [Edwards, Mitchell 2008, p. 102-113]. Mintz finds the same arguments. According to him high effective tax rates on capital result in less foreign direct investment and therefore in lower economic growth [Mintz 2007, p. 22].

Governments can respond to the increasing mobility of cooperation in either of two ways. They can try to fence in the existing corporate tax base with layers of new rules and regulations. Alternatively, governments can embrace globalization by cutting the corporate tax rate and simplifying the tax system. But if the government wants to raise taxes, it would be better to collect the money directly from a tax on wages rather than from a tax on corporate profits [Edwards, Mitchell 2008, p. 31-37]. Budgets must be balanced, lower corporate taxes implying higher labour taxes must be levied to make up the difference, and so tax competition inevitably produces a situation which punishes the immobile (labour) factors of production for being immobile.

As a matter of level of wages and corporate tax reduction, one study illustrates a positive relationship and proves that a 10 percentage point reduction in the

corporate tax rate would increase average wages by 7% in the long run [Aron-Dine 2008, p. 14-15]. The tax system has an enormous capacity to reallocate the wealth of a state. However, the propriety of using taxation for the redistribution of wealth is a political question, not an economic one. That is why it is so important to keep tax rates reasonable.

However, tax system has to reconcile business expectation with public needs which are two opposite things. Modern tax system should be first of all effective for business as well as for public finance. This is very important especially in Europe because of the social policy which creates huge costs for public finance. This is the main reason why European governments – mostly in west part of Europe – are not so prone to become more liberal towards tax policy. In spite of this there is a slow trend to reduce tax burden in Europe.

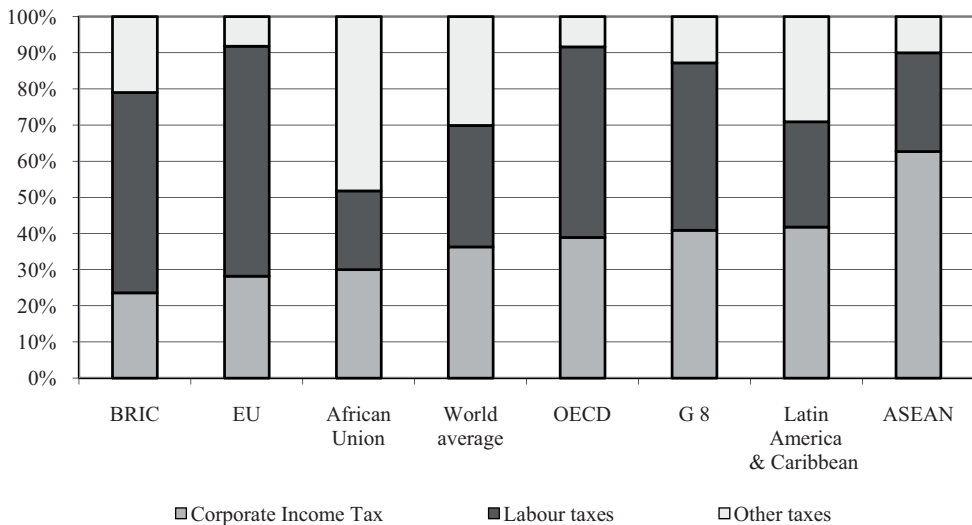


**Fig. 2.** EU comparison of total tax rates

Source: *Paying Taxes 2009. Global Picture*. The World Bank Group and PricewaterhouseCoopers, p. 31.

However, the problem of corporate tax is not only limited in Europe to the level of tax rate. Most of the countries offer a preferential solution in the field of corporate tax rate. But doing business in Europe means also additional tax costs – labour taxes. Overall they account for 34% of the total tax rate and they are a significant element of the tax cost for business. Europe continues to be a region where labour taxes are a particular feature. Figure 2 shows total tax rates for the EU split by the type of tax.

The largest element for the four economies with the highest total tax rates in the EU (Belgium, Spain, France and Italy) are labour taxes. They are also an important part of fiscal policy in the BRIC economies, the OECD and the G8 (Figure 3). The significant role of employment taxes in Europe mostly arises from social policy.



**Fig. 3.** Analysis of the total tax rate by region

Source: *Paying Taxes 2009. Global Picture*. The World Bank Group and PricewaterhouseCoopers, p. 32.

It is important to keep in mind that the effective tax burden depends both on tax rates and on how the tax base is defined. International variations in the definition of the tax base for corporate (or company) and personal income taxes, remain considerable. In Singapore and Malaysia, income tax is partially integrated through the dividend-received-credit method, while the other Southeast Asian countries employ a classical method of corporate taxation under which a dividend income is double taxed [Asher, Rajan 1999, p. 42-44]. These variations could lead to greater differences in effective rates than nominal rate comparisons may suggest alone.

## 2. The aspect of tax harmonization

There are two ways governments can constrain tax competition. First, they can simply close borders to capital and labour mobility. That was the approach followed before the 1970s and of course in the former Soviet bloc countries, but it would be nearly impossible to accomplish in today's global economy. Second, governments can pursue tax harmonization, which seeks to eliminate any advantages for taxpayers who do business outside their own country. Such an approach allows politicians to be fiscal monopolists.

The process of tax harmonization is most advanced within the European Union but the need to coordinate tax legislation especially in the field of level of tax rate is also noticed by OECD or IMF. The main questions concern harmful tax competition which was initiated by globalization.

Globalization started to change the relationship between governments and taxpayers, which prompted governments to implement a tax reform. There is empirical evidence of "power" of multinational firms. Liberalisation and increased capital mobility created the phenomenon of the multinational firm and, between 1969 and 2002, both allowed them to proliferate – growing from 7.258 to more than 63.000 – and thrive. So successful were they in fact that by the end of the century, between twenty-nine and fifty-one of the world's largest economic entities were private multinational firms. General Motors, for example, was "economically" more significant than Denmark in 2002, and Daimler Chrysler more significant than Poland, while Royal Dutch Shell, IBM and Sony were each more important than Iran, Ireland and Pakistan. Taken together, the world's top two hundred firms accounted for about 27% of global economic activity in 2000, and earned an income greater than the world's poorest 1.2 billion people [McCarthy, van Doorn, Unger 2008, p. 3-4].

For those who view tax competition as a "zero-sum game" that damages the economy, one policy prescription is to harmonize or equalize taxes across countries. The European Union has considered harmonizing member-country taxes since the 1960s. Fiscal harmonization is ruled by Article 93 of the EC Treaty and concerns only turnover taxes, excise duties and other forms of indirect taxation. It is important to emphasize in this regard that Article 93 provides that the tax harmonization has to be realized if it is necessary to ensure the establishment and the functioning of the internal market and the approximation of national rules are realized when some laws, regulations or administrative provisions of the Member States directly affect the establishment or the functioning of the "common market" [Peeters 2005, p. 327]. Currently, EU membership requires that countries impose a value-added tax with a rate of at least 15% and various excise taxes with certain minimum rates. There is no detailed EU recommendation as far as personal income taxes or local taxes are concerned.



The proposal to harmonize corporate taxes has been pushed for decades in Europe, beginning with official reports in 1962 and 1970. In 1975, the European Commission sought to implement a minimum corporate tax rate of 45%. In 1992, the Ruding Committee proposed a minimum corporate rate of 30%. But these initiatives failed, and today corporate tax rate is not affiliated with any European directives.

The European Parliament finds that harmonization of business taxes “may be required to prevent distortions of competition, particularly of investment decisions. Tax harmonization is to avoid the negative externalities that can follow an individual tax reform in one country. More specifically, cutting taxes in one country raises the competitiveness and/or attractiveness of this country relative to others. The resulting flows of goods, capital, and also, possibly high-skilled labour is detrimental to partner countries in terms of economic activity and in terms of tax revenues [European Parliament 2001].

Mitchell and Edwards find that from this perspective the whole troublesome tax competition problem would be solved if taxes were fixed at the same high rate everywhere – perhaps 60% percent for a corporation [Edwards, Mitchell 2008, p. 133-137]. That would eliminate all negative externalities. But in the face of globalization process and tax competition EU corporate tax rate would be harmonized and in the same time devastated.

There is a question: can the EU concept of harmonized tax be used as a model on which a common concept of tax for all the Member States is based on? Alternatively, should the Member States be obliged to design their domestic taxes in accordance with the general EU concept of tax?

The best answer is “no” for a lot of reasons. First, there is no general concept of tax in EU law, second, although the Member States are bound by the provisions of the EU directives, they can protect their tax sovereignty with some exceptions.

In the global market tax harmonization eliminates any beneficial downward pressure on rates. Economists generally prefer broad-based tax rate cuts and reduced taxes on savings and investment, but optimal tax policy for each country likely varies. Every country can differently look at the policies adopted abroad, see what works, and adapt the best reform ideas for the domestic tax regulation. To prove it we can use the idea of flat tax which is very popular in Central and Easter Europe (Table 2).

Flat tax was the best answer to the growing tax competition. For instance, flat tax in Slovakia has been a huge succes, and the country has attracted large inflows of foreign invetment. Slovakia’s reform played a key role in the subsequent decisions to adopt flat tax in Romania, Bulgaria, and the Czech Republic. When the Czech Republic announced its 15 percent flat tax in 2007, it prompted the Polish government to observe and finally implement flat tax for bussiness (in Corporate Tax and Personal Tax). A lot of countries which have flat tax have enjoyed strong economic growth in the recent years according to IMF data [World Economic Outlook Database, IMF]. Preferential tax environment attracted and still does large inflows of foreign direct

**Table 2.** Flat Tax Countries: Income Tax Rates, 2008

Jurisdiction	Flat Tax Adopted	Individual Flat Tax Rate	Corporate Tax Rate
Jersey	1940	20.0%	20.0%
Hong Kong	1947	15.0%	16.5%
Guernsey	1960	20.0%	20.0%
Jamaika	1986	25.0%	33.3%
Estonia	1994	21.0%	21.0%
Lithuania	1994	24.0%	15.0%
Latvia	1995	25.0%	15.0%
Russia	2001	13.0%	24.0%
Slovakia	2004	19.0%	19.0%
Ukraine	2004	15.0%	25.0%
Iraq	2004	15.0%	15.0%
Romania	2005	16.0%	16.0%
Georgia	2005	12.0%	15.0%
Kyrgyzstan	2006	10.0%	10.0%
Pridnestrovie	2006	10.0%	10.0%
Trinidad	2006	25.0%	25.0%
Iceland	2007	35.7%	18.0%
Kazakhstan	2007	10.0%	30.0%
Mongolia	2007	10.0%	25.0%
Macedonia	2007	10.0%	10.0%
Montenegro	2007	15.0%	9.0%
Albania	2007	10.0%	10.0%
Mauritius	2007	15.0%	15.0%
Czech Rep.	2008	15.0%	21.0%
Bulgaria	2008	10.0%	10.0%
Average of 25 jurisdictions		16.6%	17.9%

Source: Ch. Edwards, D.J. Mitchell, *Global Tax Revolution. The Rise of Tax Competition and the Battle to defend It*. CATO Institute, Washington D.C. 2008, p. 61.

investment in the flat tax countries. For example, in Estonia and Slovakia the stock of FDI as a percentage of gross domestic product reached 77% and 55% respectively, by the end of 2006. By contrast, in Europe it was 38% of GDP, and in US just 14% of GDP [Edwards, Mitchell 2008, p. 69].

The idea of using fiscal policy to boost the economy during a downturn was favoured by J.M. Keynes in the 1930s [Brannon 2009]. Currently taxes are the main instruments to boost economy in social policy and they are often used in the political game.

### 3. Conclusion

Harmonization is sometimes used as a synonym of globalization [Backer 2007, p. 385-386]. In reality harmonization is something quite different. It is a consequential concept. It suggests a course or a method for any of numerous forms of globalization, rather than the normative basis of globalization itself. If globalization is the objective, the substance of universalism, then harmonization focuses on the means of attaining those substantive ends. Harmonization usually suggests a search for common behaviour rules but it is very difficult in respect of tax policy. Nations have different cultures and different economies, which suggests that different tax structure may be appropriate. In some countries (Finland, Norway, Sweden or Germany) citizens want to pay higher taxes and get more government services, in others they prefer more liberal tax solutions with low taxation. In global economy every country has to find the best tax solution to achieve a competitive position. We can try to harmonize a lot of regulations but tax policy should be independent because of specific economic, social and political character.

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## TRENDY W POLITYCE PODATKOWEJ NA ŚWIECIE

**Streszczenie:** Współczesna „architektura” systemów podatkowych to kompromis między harmonizacją a globalizacją. Z jednej strony można napotkać próbę standaryzacji w podatkach, z drugiej konkurencję podatkową. Procesy harmonizacji i globalizacji, choć wydają się być zupełnie różne, mają wiele punktów stykowych, jak chociażby wpływ na wzrost gospodarczy czy poprawę warunków konkurencyjności. Bez wątpienia oba procesy wyznaczają kierunek zmian w polityce fiskalnej w większości państw, co z kolei implikuje szereg zmian na gruncie polityki społeczno-gospodarczej. Instrumenty redystrybucji budżetowej, w tym przede wszystkim obciążenia fiskalne, stały się elementem gry rynkowej, która kreuje otoczenie fiskalne głównie dla podmiotów instytucjonalnych. Efekty zmian w zakresie polityki podatkowej są także odczuwalne przez podmioty indywidualne. Jako efekt oddziaływania globalizacji i harmonizacji pojawia się specyficzny bilans fiskalno-społeczny, którego określenie jest celem artykułu.