Hunting the Hydra: Corporate Tax Reform and the EU's Next Frontier

In the summer of 1425, a man named Merten Jawerk set sail from Bruges aboard a ship laden with Flemish cloth. As the textile industry's powerhouse of the medieval period, Flemish linen was highly sought after throughout Europe, especially in the Hanseatic League, a group of free trade cities stretching from the Netherlands to Russia. In this case, Merten's destination was the Hanseatic city of Riga, meaning a long voyage across the North Sea, and most of the Baltic. It was a journey his ship would never complete. After running aground just off the island of Gotland, south of Stockholm, Merten and his crew salvaged all the textiles they could from the sinking ship and swam to safety, before finding their way to Visby, the island's Hanseatic capital.

That's where it starts getting interesting. Before departing the island to finish the journey he'd started, Merten appeared before the city court in Visby, where it was ruled by local custom that, though he had lost most of his cargo, he and his crew were nonetheless entitled to a conciliatory freight of 72 gold marks. A generous offer indeed! Merten breathed a sigh of relief, and smacked his lips, thinking of all the pickled herring he and his men could buy with that handsome sum. He happily set off aboard a new ship, and soon arrived in Riga to announce the news of the Visby ruling. But the merchants there were unimpressed. Why should they owe any such amount to this bedraggled Prussian upstart and his armful of sodden Flemish rags? They decided to ignore the freight laws of Visby, instead applying the local laws of *Riga*, under which they owed no more than a few gold marks. This much they subsequently paid, to the mortification of Merten and his now bankrupt crew.

Jurisdictional gaps and overlaps like this were hardly surprising given the Hanseatic League's rudimentary, proto-supranational structure. But what is curious is that there was a universal Hanseatic law on freight for salvaged goods, which merchants routinely ignored. They had realised that the only thing better than a general rule was a system in which they could choose the rules for themselves.

Today we might call these conniving merchants "freight law shoppers" (even if Merten Jawerk had a different name for them). In the event of a shipwreck, they would look at the freight rules in the city of origin, city of delivery, and the city nearest to the shipwreck. Whichever city offered the most advantageous laws, they would select as the relevant jurisdictional authority, and using their extensive political networks they could ensure that their claim was upheld.

This kind of behaviour is at odds with one of the major theories of supranational integration. When I use the word 'integration', I mean in broad terms the coming together of distinct states into a single union, and in concrete terms the reduction in significance of national borders, through eliminating import tariffs, and instituting legal / political unity. Because EU integration has gone further than many ever expected it would, theorists have sought to explain how this came about, many of them using what is known as neofunctionalist theory. Neofunctionalists believe that integration occurs only insofar as multinational commercial actors (on the one hand) and supranational institutions (on the

other) have their interests fundamentally aligned. The Hanseatic League can't have integrated along these lines if its merchants openly preferred pluralistic legal codes – but neofunctionalism *does* claim to explain integration in the EU.

For instance, consider the early days of European integration, where member states were still digesting the new free trade agreement. Some members allowed particular import tariffs to linger on decades after the Treaty of Rome, and blithely ignored many of the demands of the Community institutions. So how then were their promises to be enforced? The answer is: through the objections of multinational corporations. As time went on, a precedent was slowly set, whereby multinationals could take their own sovereign states to the European Court of Justice over state failures to dismantle impediments to free trade, as they had promised to do in the Treaty of Rome. In a case from 1978, Simmenthal, one of Italy's most beloved purveyors of jellied meats, took the Italian customs office to court over exorbitant private charges for mandatory health inspections on imported French beef. The European Court of Justice ruled in the company's favour, arguing that the practice violated free movement of goods provisions, and ordered the removal of health inspection charges. This case neatly demonstrates the symbiotic relationship that corporations began to nurture with the EU – you help us smooth out cross-border trade, we help you progress towards your borderless utopia. And after all, who ever liked nation states anyway?

In this way the partnership grew, as European institutions and cross border traders worked hand in hand to bring Europe closer together.

We could conclude, then, that the Hanseatic League integrated differently to Europe at some essential level. If Hanseatic businesses actively rejected standardisation of freight on salvaged goods in favour of a pluralistic system in which they could pick and choose between cities, then we were looking at something very different from the harmonious partnership between the EU institutions and big business.

But hang on a second. What harmonious partnership? Recent history seems to tell quite a different story from the neofunctionalist narrative. The European Commissioner for Competition has spent the last six months cracking down on the selective tax advantages enjoyed by some of the largest corporations operating in Europe. Just last month, the Commission found Luxembourg and the Netherlands guilty of using promises of selective tax advantage, known as 'letters of comfort', to lure investment from Fiat and Starbucks respectively. Both countries were ordered to recoup 20 - 30 million euros in overdue taxes. The EU doesn't want countries offering 'letters of comfort' to attract investment, and it doesn't want multinationals going shopping among EU tax regimes for their own advantage.

Who are the main culprits? They are all familiar names. Apple, with its non-U.S. base just outside the city of Cork, has negotiated with the Irish government to whittle its effective European tax rate down to 3.7%. Amazon's European operations are run through a subsidiary in Luxembourg, which in 2013 meant that it paid only €75 million in European taxes despite notching up 200 times

that figure in European sales. And in 2014, Facebook paid less UK tax than the average British citizen; proof that you don't get to a billion friends without making a few enemies, among them the department of Her Majesty's Revenue and Customs.

Fortunately, the EU's increasingly tough stance is starting to make a difference: as well as the direct action taken against Luxembourg and the Netherlands, fear of similar proceedings drove Amazon earlier this year to begin booking its transactions in the countries of purchase rather than in Luxembourg. But the corporations certainly aren't happy about it. If the interests of Europe and big business were once aligned, they're not anymore: commercial actors in the EU want to remain tax treaty shoppers every bit as much as the Hanseatic merchants wanted to keep their freight options open.

So what does this mean for European integration? If we've reached a point where corporations and the supranational institutions are no longer working in concert, then perhaps we've reached the limits of neofunctionalist theory's usefulness. But equally, the neofunctionalist framework invites us to open up a larger question about the new direction the EU is taking: if it's pitting itself against both states and business, then what allies does it have left? What indeed is the point of a move that apparently runs counter to the preferences of all parties concerned?

Well, I hope I don't sound too trite when I say the words social justice. But it is justice, on two fronts: the first is the enforcement of rules that should apply to *everyone*. And this is something which just isn't said enough in this debate: it's not a matter of *raising* taxes – it's a matter of enforcing *the same taxes* for every company operating in any given country. Recently a Welsh town named Crickhowell has garnered media attention for using the same accountancy techniques as Google and Starbucks to avoid tax. Their purpose is to ask why local coffee shops, opticians and salmon smokeries should be paying the kind of tax that multinationals so skilfully avoid. The second front is a redistributive justice, which would ensure that all of society draws some social benefit from a company's success.

Both are noble causes worth fighting for, and an EU-wide solution appears to be the most plausible way of getting it done. But what does this mean for Europe, and how do we go about it? Well first of all, it's worth observing that the creation of a European platform for taxation policy would mark an ambitious new stage of European integration. By parting ways with the interests of multinational commercial actors, Europe is entering uncharted waters, in which it will no longer be able to rely on big business holding nation states to account. That old dynamic, although it will continue in other, less sensitive areas of policy, will not help as the EU attempts to solve a problem in which both states and corporations are complicit. If it succeeds, this new stage will also give real meaning to that otherwise hackneyed line trotted out by Brussels devotees: that for global clout, Europe's nations need to band together. If banding together means finding a decisive solution to corporate tax avoidance, then that could be just the ticket to restoring a sense of the European Union's *raison d'être*.

But caution is to be exercised. EU authority is being questioned now more than ever before. At last year's parliamentary elections, it suffered the double indignity of record low turnout and sweeping Eurosceptic victories. The last thing the Commission needs is to alienate its member states even further. By bringing competition law rulings against the Netherlands, Luxembourg and Ireland, the Commission has picked its targets tactically; Europhiles by nature, all three will ultimately accept the rulings without considerable public backlash.

The same cannot be said for another serial offender: the United Kingdom. Already officials have complained that the Commission is only going after minnows, while the UK turns a blind eye to corporate tax regimes in Gibraltar, and gets away with it. With the approaching British in-out EU referendum, there's good reason to be circumspect about the Eurosceptic backlash to direct interference in taxation. But here's the thing about this tax reform – as with so many objectives at a supranational level, it'll only work if everyone cooperates. Because corporate tax avoidance is a hydra. You can cut a few heads in the Benelux, but they'll soon grow back if you can't get the others too. If Starbucks simply moves its base from the Netherlands to a country the Commission dare not confront, the shopping will continue and the problem won't be solved. And how long would the Dutch keel to EU directives if they knew that the British were flouting them with impunity? If the Commission is to succeed in its goal, it will soon have to confront Britain, and with it Greece, Spain, and each of the bastions of Euroscepticism. If it doesn't, the whole programme dissolves, and the insidious Hydra is restored to its full health.

On this count, the Hanseatic League egregiously failed. When it introduced its universal decree on the freight on salvaged goods in 1447, it neglected to consider the mercantile response, and did not develop an effective enforcement mechanism. Few cities observed the laws in the first place, and fewer still as time went on, undermining the League's organisational authority. Within a couple of decades the freight laws had lapsed entirely. The EU must not make the same mistakes. It will have to strike a fine balance between acknowledging the desire for fuller sovereignty in some member states, while at the same time directly challenging them on policies of selective tax advantage. It will have to strike out against governments' letters of comfort, and against companies which pay their taxes to havens rather than the markets in which they operate. But whatever it does, it will have to strike fast.

The neofunctionalist model of European integration always claimed to offer a happy, gradual progress towards a federalised United States of Europe. Only now is it becoming clear that if that picture ever becomes a reality, neofunctionalism won't be what got us there. The next chapter in the story of EU integration will be defined by how well it copes when the corporations are *no longer* in its corner. It'll be a rough ride, but the rewards are great. Because the best defence that the EU has against the crisis of legitimacy it faces is to make itself relevant again – and delivering the many scalps of a many-headed corporate tax avoidance culture promises to do just that.