

**THE NATIONAL INTEREST IN EU LAW AND GOVERNANCE: THE HUNGARIAN
PERSPECTIVE 4**

FINDINGS OF THE

MUTUAL LEARNING EXPERIMENTS (MLEs)

CONDUCTED BY THE LENDÜLET-HPOPs RESEARCH GROUP IN AUTUMN 2015

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1. Introduction

The MLEs were conducted with two purposes in mind. Firstly, we aimed to collect insights from officials working in the Hungarian and the European Union administration at the expert level concerning how they understand the national interest in the policy development and decision making processes in which they participate. Secondly, we wanted to share with them different interpretations and perspectives of formulating and representing the national interest/national position in the EU political and legal context, as they follow from academic work. The MLEs were not conducted as formal research interviews and their results are not used directly in our research. This is an overview of what we –as academic researchers – learned from the events. Therefore, the following account is not an exact report of the discussions.

2. Summary of findings

- EU membership has transformed the formation and the representation of the interest of the country in Hungary;
- while it has reduced the opportunities for autonomous unilateral interest representation, it offered a novel political and legal framework for the promotion of national interests at the European level;
- on balance, this consequence of EU membership may be to the benefit of a country with a relatively small size and influence, such as Hungary, which, however, needs to be assessed on a case-by-case basis;
- the political role of successfully completing the EU presidency has a strong impact on the formulation and representation of local interests;
- EU membership made the domestic policy-process more aware of the necessity of articulating local interests and to calculate the restraints imposed upon those interests and the possibilities offered to represent and/or protect them under EU law;
- for policy-making in Hungary designing domestic policies while giving effect to the relevant EU obligations, no matter how indirect may be represents a considerable challenge, as the local policy trade offs and compromises may be difficult to achieve and maintain under pressure from distant provisions of EU law;
- there are clear areas of conflict between EU and Hungarian interests, which may have a basis in more fundamental disagreement about directions in the given policy domain;
- there are clear areas of conflict between the interests of different Member States of the EU and, therefore, it is necessary for Hungary to be able to control, or at least influence the EU policy-making process where the interests of other Member States may be given a leading role.

3. The national interest in the context of domestic tax policy

The MLE focused on formulating and representing national interests in the context of national tax policy with regards to the legal obligations and policy restrictions following from EU membership. It found that with EU accession the possibilities of national tax policy have changed fundamentally. While, in principle, Hungary retained most of its tax competences within national tax sovereignty, EU law put considerable pressure, in the form of EU tax harmonisation, obligations under the fundamental freedoms, especially those arising under the non-discrimination principle, and obligations under State aid law, on the ability of Hungary to achieve redistributive and other policy objectives through taxation. These constraints also apply in the international tax relations developed by Hungary. Furthermore, there is a different kind of pressure coming from the EU; that under the Europe 2020 economic governance framework requiring Hungary to adjust its tax system in a manner that it secures revenues but does not suffocate economic growth. The international and European dimensions of domestic tax policy now receives considerable attention, which can take place in the form of maintaining regular contacts and consultations with EU experts, or of concluding bilateral tax agreements with other States and taking part in multilateral mutual cooperation frameworks.

For national tax policy, the top to the bottom intervention by EU obligations complicates the already complex task of developing policy directions and introducing concrete tax measures having considered the trade offs and the related policy dilemmas inherent in taxation. The national government has primary responsibility for making choices between redistributive objectives and the interest of economic growth, ensuring competitiveness and mounting an effective challenge against tax avoidance, taxation on the basis of the location of the income generated and taxation on the basis of the nationality of the tax subject, neutrality in competition and taxation and the interests of domestic businesses, and between SMEs and large multinational corporations.

Hungarian tax policy clearly recognised the changes in the international context following the global economic and financial crisis. Before the crisis, liberalisation and deregulation were the policy buzzwords, which meant an ever increasing relevance for value added taxes thought to distort the economic and to distort decisions concerning employment, establishment and investment less than other forms of taxation. In international taxation, non-discrimination was achieved by preferring taxes determined with regards the country of destination, and tax competition was supported, as in a globalised economic setting a more effective State and a more effective tax structure seemed to offer advantages. Some aspects of tax competition were considered as damaging, namely practices of tax optimisation leading to the transferring of profits to low taxation States, which aim to maximise these processes. After the crisis, the tax gap in individual States became very real problem requiring political and legal responses.

Unilateral and international action was taken to secure a more effective enforcement of tax obligations and to address international inequalities and responsibility for tax avoidance. The interest of securing revenue often enjoyed priority over the interests of long-term competitiveness.

Hungary has also been active in preparing the post-crisis framework for international taxation, primarily under the OCED framework. It clearly has an interest in developing multilateral tools to address tax avoidance and to deal with frameworks which enable tax avoidance. Ensuring coherence at the systemic level and introducing uniform solutions are central to this new agenda (deductible incomes should not be taxed elsewhere). Finding a substantive approach is another cornerstone (tax incomes where economic activity is carried out). Increasing transparency is another potential direction. The method of pursuing these agendas in multilateral, instead of bilateral or unilateral (e.g., US ACTA) frameworks, however, may not coincide exactly with Hungarian interests. The larger States are able to represent their interests in designing new multilateral frameworks more forcefully than the smaller States, which latter are placed under a direct pressure of alignment, in particular in terms of increasing local tax burdens and, thus, reducing the income available for taxation in other States. This is rather problematic as all States are reluctant to support international taxation frameworks which erodes their tax base, despite the long-term benefits offered by liberalised capital movements and cross-border establishment. Hungarian interests by-and-large coincide with developments consisting of imposing new, mainly procedural standards, or substantive standards capable of effecting decisions concerning the location of establishment, on international tax planning centres (States).

As a Member State of the EU, Hungary has to accept that the major direct taxes are subject to legal harmonisation, which does, however, leave some room for national policy developments in the areas of determining the level of taxation, or providing tax advantages and tax breaks. In the areas of direct taxation, although their regulation remained in national competences, they are subject to different forms of EU intervention. These may follow from EU legislation (IP and company law), soft-law concerning code of conduct in taxation, Commission recommendations concerning taxation, the fundamental freedoms, State aid law, and from EU economic governance (under the European semester framework). This latter may be highly problematic from the perspective of smaller Member States: they have very little influence on the formal act adopted by the Council, they are unable to influence the expert opinion formulated in preparation by the Commission and the Commission experts, and they may have limited options in ensuring that private business interests are not overrepresented in the relevant documents. The ability of the Member States to influence decision-making may also be limited in regular EU decision-making processes: tax-relevant proposals by the Commission may not be presented as a tax dossier

The major disagreements and interest conflicts within the EU in the field of taxation have been recognized by Hungarian tax policy. The larger capital-rich and capital-

exporting Member States, which impose a higher tax burden on tax subjects and have a less competitive tax system as a matter of structure, but not as a matter of enabling tax compliance, face considerable risks as a matter of the erosion of the national tax base and the transfer of profits to lower taxation States. The smaller capital-rich Western European Member States can emerge as the winners of international tax optimisation practices, provide that they position themselves as international tax planning centres. The capital importing Eastern European Member States, where the local branches and subsidiaries of multinationals have a large influence on policy-making, face difficulties in preventing the exportation of profits and they aim stopping the deduction of (corporate) tax at source, which latter has an impact on local competitiveness but also poses problems as a competitive disadvantage in international comparison.

The locally formulated interests of Hungary in the field of taxation are based on the realisation of the positive and negative impacts of the free movement of capital and freedom of establishment on its ability to exercise their tax powers. The geographical unevenness of capital movements in what is regarded as an integrated market is also taken into account. On the one hand, Hungary is a capital importer State which relies on foreign investment in creating and maintaining the export oriented sectors of the national economy. On the other, the fundamental freedoms undermine the possibilities of actors in the national economy that produce for the domestic market, mainly as a result of the exclusionary effect of incoming foreign investment and of its effect on decisions of these actors concerning domestic capital accumulation. There are also practices of incomes produced in the Hungarian economy being exported by foreign investors. Another key point of Hungarian tax policy is the ensuring of the global competitiveness of the national economy, which is pursued very intensively through implementing a competitive system of corporate taxation. The interests of foreign investors have traditionally played an important role in defining the applicable tax rules. Competitiveness was certainly the central factor in the restructuring of the domestic tax structure after the global financial and economic crisis, especially after the elections in 2010. Corporate taxation was made even more competitive, the tax burdens of employment were reduced somewhat, in turn value added taxes were increased and special sectoral taxes were introduced, and efforts have been made to strengthen tax compliance. It is accepted that these changes in the domestic tax structure paid less attention to social equality and equity than before. The special taxes were targeted on non-exporting, oligopolistic markets populated by larger undertakings, the operation of which does not interfere with export-focused Hungarian economic policy. The tax structure seems to be aiming at ensuring that while capital imports increase, investors are discouraged from exporting capital from the country, unless they meet the high tax burdens. Further tax reductions are constantly on the political agenda.

These changes led to conflicts with the EU in three areas: the system of corporate of taxation contradicts broader EU trends, specific sectoral taxes are investigated for the violation of EU obligations, and the agenda of introducing multilateral framework for cross-border taxation is in conflict with local tax interests. While some of these conflicts

were anticipated on the basis of the knowledge of the applicable EU rules, others were more unexpected, especially the challenges of specific sectoral taxes under EU State aid law. It is suspected that in the domain of specific sectoral taxes the conflict between Hungary and EU is not simply legal, but it is based on different economic analysis of the impact of these taxes on economic activity in the integrated market (i.e., the selectivity of these taxes is disliked as well as their progressive nature, while they agree that these are types of taxes which are generally harmless (economic operators can pass these taxes onto their consumers, therefore, it does not affect their decisions concerning investment and employment)).

Interest representation in the EU follows the usual avenues, but there may be instances in the near future when Hungary may consider using its veto powers in the field of taxation (e.g., the proposal of minimum levels of taxation which favours larger, high-taxation Member States). Harmonisation in direct taxation is unlikely to be supported by Hungary (i.e., the pressure comes from the larger Member States, and smaller Member States fearing that it will lead to the erosion of their tax base try to resist). Measures on mutual cooperation in tax administration and tax enforcement are more welcome.

4. The national interest in the context of EU economic governance

The MLE revealed that domestic economic policy faces considerable political, policy and legal limitations under the EU economic governance mechanisms established (reinforced) after the global financial and economic crisis. While economic policy competences remained with the Member States, hard and soft obligations of alignment and compliance now follow not only from concrete provisions of EU economic law, but also from the scrutiny and reporting mechanism set up under the European Semester framework.

Since the completion of the first European Semester period coincided with the Hungarian presidency, which also involved the adoption of the so called 6-pack measures, in the context of this domain of high European politics the Hungarian interest overlapped with that of the EU interest.

There are clear conflicts of interest among the Member States under the EU economic governance framework. The most obvious is that between the larger credit-providing and the indebted Member States which led to considerable disagreements concerning the implementation and the enforcement of the new EU framework for fiscal policy coordination at the national level. It was realised from earlier on that the costs of implementing the EU economic governance framework will be different in the different Member States.

The EU economic governance framework also revealed clear conflicts between the Union interest and the interests of the Member States. The direction of maintaining and deepening the EMU, the coordination of cross-border policy implications of national economic policies, and the integration of euro-zone and non-euro-zone Member States under a common economic policy framework, as represented by the Commission, was not particularly welcome politically and in policy in every Member State. This had an important impact on the effectiveness of EU economic governance as its implementation depends primarily on national governments introducing, within their own competences, structural reforms and changes in domestic fiscal policy. National politics determining the abilities of national governments to carry out potentially unpopular policy change, which could involve departure from earlier made political and social compromises concerning, for example the role of the State and the market, the size of redistribution, or the role of law in governing the economy, thus, had a serious effect on the achievement of EU-determined fiscal and economic policy objectives. The question that arose was whether the Member States could actually be trusted with the implementation of a common policy, which was supported by them in principle but was subject to considerable resistance at the level of national politics.

It must, however, be realised by individual Member States that EU economic governance was not put into place to be enforced using top-down mechanisms of enforcement. Compliance with a policy developed independently from the Member States, which aims to achieve results in a medium and longer-term, is in fact in the interest of the Member States. Following the recommendation through domestic policies is not an act of compliance but Member State governments working on the achievement of policy objectives in their own interest. Non-compliance will hurt the non-compliant Member State, therefore, Member State resistance in the national interest is difficult to interpret in this framework. Necessarily, the performance of other Member States is in the interests of individual Member States as non-compliance in one Member State puts the performance of the whole European economy to jeopardy.

This idea of self-compliance is also interesting from the perspective of short-term violations of EU obligations or other acts of unilateral Member State opportunism. On the one hand, the Member State concerned will damage its own interests (i.e., domestic economic operators or private individuals), as expressed in the objectives of the EU economic governance framework. On the other, the results of non-compliance will be unsustainable and non-compliance will be given up within a shorter period of time. As a matter of managing non-compliance in the economic governance domain, this means that the Commission may decide to focus on the most obvious violations using these procedures to moderate national policy bearing in mind that possibly in mid-term non-compliant behaviour will be given up. The other solution is to get closer to the Member State concerned and to economic policy-making in that Member State. With this, it can be more directly clarified that compliance is in the interest of the Member State concerned, especially because the outputs of the EU governance mechanisms contain country-specific instruments.

The consequence of national fiscal and economic policy having been subjected to considerable controls from the European level meant that the Member States were keen to resist the common policy framework and which resistance had to be countered in the process of adopting that framework. It was, therefore, crucial to secure the political support of Germany and France as the two largest euro-zone Member States and of the European Parliament. The abilities of individuals negotiating in the different fora also had particular relevance.

From the perspective of the EU-led response to the global financial and economic crisis, it is difficult to assess Hungarian responses and Hungarian recovery as most instruments were introduced in national competences and the compulsory euro-zone measures were not applicable. There is certainly the possibility of comparing different pathways of responding to the crisis which may provide a basis for the assessment of the benefits and the risks of EU-governed local responses, on the one hand, and autonomously determined local responses to the crisis, on the other.

In principle, the new framework of EU economic governance provides unprecedented possibilities for the Commission and the other Member States to look into and intervene the performance of a Member State in the fiscal and economic policy domains. Necessarily, this has led to considerable disagreements at expert level concerning the methodology applied, the indicators collected, and the possible conclusions to be drawn. The economic analyses carried out are subjected to intensive expert and political negotiation in the Council aiming to interpret, challenge or modify the Commission's primary evaluation.

Centralised mechanism of fiscal and economic policy coordination in Europe necessarily raises the question whether it is able to recognize and accommodate regional economic and social differences, as a matter of structural problems of the national economy, the impacts of market integration including the EMU, or the particular geopolitical situation of the region or the Member State concerned. It was raised that because most of these inequalities and differences had existed before the crisis, there may not be a way to take them into account in the post-crisis environment. Basically, the advantages and disadvantages of EU membership are difficult to measure – pre- or post-crisis (i.e., the core-periphery differences and conflicts are not black and white), and, therefore, individual grievances may be impossible to be addressed in a collective governance framework. Also, the EU policy maker has to take into account the interests of the whole of Europe which leaves very little room to have regard to locally framed interests. Necessarily, flexible common rules or exceptions from the common rules (e.g., flexibility in designing Member State public budgets) may give the desired local leeway to national governments. Nonetheless, at the political level the balance between the common benefits and the local disadvantages of common policies must be carefully considered and should be subject to ongoing discussions.