

# A Historical Study of the Common VAT System in the European Community

## - Focusing on questions over fiscal sovereignty and fiscal neutrality -

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Anna KONISHI

Ph.D. candidate of University of Paris I  
Panthéon-Sorbonne

### Background

Introduced in France in 1954, the **Value-Added Tax system (VAT)** is presently adopted in over **150 countries**. In spite of its regressive tax burden, this has been one of the main sources of tax revenue in many countries.

The first transmission of the VAT system was witnessed in European countries between the late 1960s and 1970s. The directives of the **European Economic Community (EEC)** Council adopted in April 1967 that **a common VAT system** would be applied across the board within the EEC. This decision is an element which helped spread the VAT system throughout the world.

### Questions

The introduction of a common VAT system in the EEC is considered as a simple European policy in order to realize a free trade within Member-States. However, if we investigate the path to a creation of a common VAT system from fiscal history perspective, we realize other meanings of the introduction of this system: **fiscal neutrality and partial abandon of government fiscal political power**.

**How could these crucial changes in the modern fiscal history be shared by Member-States ?**

### Political Initiatives of the European Commission

#### The Commission pushed for fiscal neutrality

< **European Commission promoted the European Integration** >

In the first phase of the creation of the common market, the European Commission worked to institute a **customs union** among the member-States. However, Commission members realized that although they abolish all customs duty, some barriers would remain if Member-States keep different tax systems. — **Fiscal Harmonization**

< **Problems in the cascade tax system** >

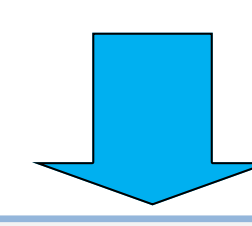
Above all, the Commission focused on the **differing sales tax systems** among Member-States. Towards the end of the 1950s, all Member-States with the exception of France implemented a **cascade tax system** through which tax burdens included in previous transactions could not be calculated in a precise manner. This difficulty induced governments to settle its tax rates in order to protect their own industries, such as customs. — **Avoiding the Cascade Tax System**

< **Cascade tax: another issue** >

The Commission also argued that the cascade tax system induced a vertical integration of enterprises and deemed such a situation unsuitable for a Common Market, insisting that the distortions provoked by the tax system should be eliminate. However, **this idea cannot be deducted directly from the concept of a common market**. — **Fiscal Neutrality**

#### Fiscal Policy Goals for the European Commission

1. **Fiscal Harmonization**
2. **Avoiding the Cascade Tax System**
3. **Fiscal Neutrality**



Introduction of a common VAT tax system

**How did fiscal neutrality become a goal of the Commission's fiscal policy ?  
Why was the VAT system adopted as an ideal tax system for the common market ?**

### The VAT system as a neutral tax

#### Organization of the European Commission - Ordoliberalism -

< **Directorate C « tax policy » » >**

In the Commission, the administrative unit responsible for questions on fiscal policy is the **Directorate C « tax policy »** in the **Directorate-General for Competition (DG IV)**. This administrative position of the unit is crucial in determining the direction of fiscal policy of the Commission.

< **Culture of the DG IV** >

**Hans von der Groeben**, the first German commissaire responsible for the competition policy, organised the DG IV and placed the importance of competition policy in the EEC. He considered that **individual liberty** must be guaranteed in the common market. Speaking further, he tried to organize the Community through the **competition principles**. This idea came from **ordoliberalism**, which was influential within his own government in Western Germany.

< **Ordoliberalism and tax policy** >

From this point of view, the proponents of ordoliberalism argue that the fiscal system should be **neutral to individual choice** as far as possible. This is why the fiscal policy prepared by the Directorate « tax policy » called for **fiscal neutrality**. This would allow for the **depoliticization of the tax system**. **This idea was inconsistent with Member-States' position which considered the tax policy their effective political tools**. → **Other approaches were required for the justification for a common VAT system**.

### Other approaches to a common VAT system

#### Empirical Justification — France as Founder of the VAT —

< **Impact on fiscal policy of the Community** >

The French government was not open to fiscal harmonization and the abolition of the tax frontier for a common market. However, its experience of the VAT system provide **a veritable example** for the Commission, who pushed for the introduction of the VAT system in the Community. However, the introduction of the VAT system in France had not been pushed by the idea of ordoliberalism. The French VAT system is **an important legacy of French history**.

< **Fiscal neutrality = justice** >

Indeed, already in the 1920s, fiscal neutrality was an important principle for French tax policy. But this idea has been supported by its specific social and economic structure. In short, the idea of fiscal neutrality was thought to be **an effective political tool for social justice**. For this reason, the French government worked on reforming its sales tax system from the 1920s onwards to assure improved neutrality. As a result, sales tax became a main tax resource for the French government.

< **Introduction of the VAT system** >

In 1954, **Maurice Lauré**, a fiscal administrator, proposed a sales tax reform in France. The new tax, the VAT, was payable on purchases of goods or services intended for intermediate consumption, gross fixed capital formation or for resale which a producer was permitted to deduct from his own VAT liability to the government in respect of VAT invoiced to his customers. This tax was favourable to French **economic modernisation**, which was crucial for the French government after the Second World War.

#### Theoretical Justification — International Tax Experts Network —

< **Columbia school and Carl Shoup** >

Another factor that contributed to the advancement of a common VAT system was the theoretical justification provided a group of tax experts at Columbia University. Differing from the proponents of ordoliberalism, these economists considered the public finance system an important governance tool for society. They argued that a suitable tax system should be induced from **the organization of society** itself. From this point of view, they proposed **the introduction of a common VAT system** because this system allowed **the abolition of fiscal frontiers, upon** which the existence of a common market depended.

In the American institutionalist tradition, the scholars of this school attached importance to **historical and social elements** in their analysis. In the domain of fiscal policy, **Carl Shoup** is one of important experts who investigated fiscal harmonization in a common market.

< **Special committee in the Commission** >

In the spring 1960, the Commission created « **Fiscal and Financial committee** » to examine fiscal systems suitable for a common market, and **Shoup** was the only non-European invited as a committee member. The committee insist an introduction of a common VAT system after the consideration of numerous social and historical aspects in the Community.

### Conclusion

The introduction of a common VAT system is based on the fiscal neutrality and partial abandon of government fiscal political power. In order to set this politically difficult aim as a goal, it was not enough to emphasize the importance of ordoliberalism government —the French experience of VAT system and the theoretical justification of the Columbia School were also necessary. After careful preparation for the project, the Commission succeeded in proposing a plan for an introduction of a common VAT system in the beginning of 1960s and the real introduction of the common system has been realized after 1970. After that, the weight of VAT has been increasing in the tax revenue of Member-States. This shows that the tax system including the idea of fiscal neutrality has taken root in these countries. In this sense, the introduction of the VAT system itself helped a spread of the idea of fiscal neutrality.