ENHANCED COOPERATION: THE WAY OUT OR A NON-STARTER?

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I. Introduction

Provisions regarding "closer cooperation" between EU Member States appeared for the first time in the 1997 Amsterdam Treaty. Three years later these provisions were augmented and restated, by means of the Treaty of Nice, now using the term "enhanced cooperation". In the Constitutional Treaty, the Nice mechanism has been subjected to further changes. Enhanced cooperation is frequently hailed as being the way out of the current deadlock in EU decision-making and as an important possibility to proceed with European integration in selected areas. However, neither the "closer cooperation"-mechanism of Amsterdam nor the "enhanced cooperation"-mechanism of Nice (which became effective on February 1, 2003) has been used so far.

In this chapter it is argued that enhanced cooperation constitutes just one of the many possibilities EU Member States have for flexible integration. First, there is the use of "alternative integration" outside the EU legal framework (*inter se* agreements, parallel procedures). Examples include the Bologna Process in higher education, the Schengen Agreement on border control (later incorporated into mainstream EU integration) and the European Patent Organization. Secondly, there are other forms of differentiated integration within the EU framework besides enhanced cooperation, like transitional arrangements, temporary derogations and/or exemptions, and constructive abstention. Thirdly, in some fields "enhanced cooperation" has *de facto* been brought about without explicit use of the mechanism. The prime example here is the development of the Eurogroup, as a byproduct of EMU.

The scant use of enhanced cooperation may be due to the fact that in its current legal set-up it is subject to several conditions, of a substantive and procedural nature. Although (in the first and third pillar) the Nice Treaty did away with the so-called emergency break procedure of Amsterdam (which constituted an effective veto right for Member States opposing enhanced cooperation), enhanced cooperation is still regarded as a means of last resort, which clearly shows in the current provisions (Articles 11 and 11a TEC and Articles 27a-e, 40–40b, 43–45 TEU). Still, in some policy areas (environmental policy, corporate taxation) enhanced cooperation regularly pops up as a (second-best) solution to the problems of insufficient integration and/or systems competition.

This chapter is structured as follows.

Section II deals with conceptualizing different types of sub-integration (or: flexible integration), i.e., integration that takes place among some but not all EU Member States. Subsequently, the focus is on two types of sub-integration: alternative integration and differentiated integration. Section III deals with the actual use of alternative integration in several—selected—policy areas, showing the pros and cons of this type of sub-integration. Section IV then discusses the use of differentiated integration in the EU by means other than enhanced cooperation. Section V is concerned with the enhanced cooperation mechanism and the conditions that are currently laid down in the Treaties. Section VI analyses the possibilities for enhanced cooperation, with a special emphasis on EU corporate tax coordination. Section VII concludes.

II. Sub-Integration

Sub-integration refers to an instance of integration that takes place among some but not all members of an already existing (larger) integration, and it can take different shapes. The first distinctive feature is whether sub-integration takes place within the EU institutional framework or not. The second feature refers to the policies that are involved. Sub-integration can deal with policies that are within or outside of the EU policy domain (as marked out by the relevant EU Treaties).

If sub-integration uses another institutional framework than the EU framework it can either be labelled new integration or alternative

integration.[1] *New integration* refers to sub-integration outside the EU institutional framework dealing with policy areas that are not part of the EU policy domain. Sub-integration outside the EU institutional framework, concerned with policy areas that are within the EU domain, is called *alternative integration*. In both cases it is possible to cooperate either among EU Member States only or with outsiders as well (third countries).

If sub-integration occurs within the EU institutional framework, there are again two possibilities. One may call *odd integration* sub-integration that employs EU institutions but deals with policies outside the EU domain. The term *differentiated integration* is used to denote sub-integration taking place both within the institutional framework and within the policy domain of the EU. Table 1 shows the four basic types of sub-integration.

Table 1

Four basic types of sub-integration		
	Use of EU framework	**Use of alternative framework**
Policies within EU domain	Differentiated integration (including "enhanced cooperation")	Alternative integration
Policies outside EU domain	Odd integration	New integration

In the literature a large variety of concepts and terms has been put forward to denote certain types of sub-integration or "flexibility": *inter se* agreements, partial agreements, parallel procedures, two-speed Europe, multi-speed Europe, multi-speed integration, European vanguard, *avant-garde* group, *directoire*, pioneers' clubs, pioneers and followers, core Europe, *Kern Europas*, *Harter Kern*, *noyau dur*, *centre de gravité*, centre of gravitation, variable geometry, *géometrie variable*, Europe à la carte, pick-and-choose, differentiated Europe, *Abgestufte Integration*, two-tier Europe, multi-tier Europe, *plusieurs niveaux*, concentric circles, *cercles concentriques*, magnetic fields, hub-and-spoke-Europe, eccentric ellipses, opt-in arrangements, opt

[1] The distinction between the four types of (sub-)integration is based on but different from Su, who uses the terms opt-out integration (rather than alternative integration) and alienated integration (rather than odd integration). H. Su, Politics of Differentiated Integration: A Comparative Study of Enhanced Cooperation in the EU and the Pathfinder in APEC (paper EUSA 9th Biennial Conference, Austin, Texas, 2005).

out arrangements, constructive abstention, declaratory abstention, positive abstention, active abstention, transition periods, special treatments, derogations, exemptions, flying geese, breakaway riders and pelotons.[2]

All of these concepts deal either with alternative integration (discussed below in section III) or with differentiated integration (discussed in section IV).

III. Alternative Integration

Europe is abounding with integration outside the EU framework. EU Membership does not imply that countries have given up all other treaty-making authority, which is exercised in relation with third countries or fellow Member States. Such agreements are called *inter se* agreements, partial agreements, or parallel procedures. Some examples of alternative integration are: the Benelux cooperation between Belgium, the Netherlands and Luxembourg, the monetary union between Belgium and Luxembourg (which was later incorporated into the EMU), the Nordic cooperation between Finland and Sweden, the Schengen cooperation based on an Agreement signed in 1985 (which later did became part of the EU framework by the Treaty of Amsterdam), the Common Travel Area between the UK and Ireland, the Bologna Process dealing with higher education which now involves 40 European countries, the European Patent Organisation, the cooperation within the framework of NATO and the Western European Union (WEU), the cooperation within the OECD, and various other bilateral or multilateral treaties on tax issues, environmental issues, culture and education.

In some of these cases (for instance the Benelux) the term alternative integration as a form of sub-integration may be misleading, because the "alternative" cooperation was already there before the larger integration within the EU framework came about. The EEC Treaty specifically did not put an end to existing bilateral or multilateral treaties, a line which has been held on to with the various accession treaties. Also, some of these forms of cooperation do not so much deal with functional cooperation (i.e. cooperation in a specific policy area) but have developed into forms of structured

[2] For overviews of concepts of "flexibility", see e.g., H. Wallace and W. Wallace, "Flying together in a larger and more diverse European Union" (Working Document 87, The Hague: WRR, 1995); A. Lansdaal, "Differentiation or Enhanced Cooperation. Formalizing Flexibility", in A. Schauwen (ed), *Flexibility in Constitutions: Forms of Closer Cooperation in Federal and Non-Federal Settings* (Amsterdam: Europa Law Publishing, 2002), pp. 47–57; *Federal Trust, Flexibility and the Future of the European Union* (London: Federal Trust, Oct. 2005).

coordination of views in order to maximize influence on collective decision-making. Again, the Benelux is an example of such a structured coordination, as is the Nordic cooperation between Finland and Sweden.

Below, closer attention will be paid to four examples of alternative integration: the Schengen Agreement, the Bologna Process, the use of bi—and multilateral treaties in corporate taxation, and the European Patent Organisation. Subsequently, some general inferences on the pros and cons of alternative integration will be made from these examples.

1. The Schengen Agreement

The Schengen Agreement (Schengen I) was originally signed in 1985 by five European countries: Belgium, Luxembourg, France, Germany and the Netherlands. It established the steps to be taken to create an area free of border checkpoints (the so-called Schengen area). An additional document (the Schengen Convention, or Schengen II) was created to implement the Schengen Agreement. Since 1985, additional countries have also signed this Convention, including the non-EU-members Iceland, Norway and Switzerland as well as the acceding countries Bulgaria and Romania, but excluding EU-members Ireland and the United Kingdom. The current Schengen Area comprises 15 countries, as implementation of the Schengen Convention is still pending for the new EU–10 Member States as well as for Bulgaria and Romania[3], and for Switzerland.

Schengen was preceded by the Saarbrücken Agreement (*Sarrebruck Accord*) between France and Germany, in which a gradual abolition of border controls between the two countries was envisaged. This agreement was a strategic action of Germany and France to encourage other Member States to abolish internal border controls within the Community so as to facilitate further economic integration. The hope of a spillover effect was a very important aspect in the conclusion of the Accord.[4] The other countries involved in the Schengen Agreement, the Benelux countries, already had abolished their border controls—for Benelux residents—in 1960.

France and Germany initiated Schengen independently of the EU, partly because of the fundamental lack of consensus among EU Member States on

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[3] As Schengen has become part of the acquis, there is no possibility to opt out of Schengen for acceding Member States.

[4] A. Arifkhanova, The Origins of the Schengen Agreement (Tallahassee: Florida State University, 2006).

the issue of open borders. Especially the United Kingdom wished to maintain its own relatively strict border controls (effectively forcing Ireland to stay out of Schengen as well, as both countries are part of the so-called Common Travel Area).[5] Schengen's independence from the EU was also in part due to differences in implementation ability: some countries did not wish to wait for others who were willing to abolish border controls but were not yet ready.[6] Its independence from the EU also made it possible for Nordic countries like Norway and Iceland to join Schengen, thereby preserving the open borders agreement between the Nordic countries that had been in place since 1952 (Nordic Passport Union).

Since its first implementation in 1995, the Schengen Agreement has undergone two major changes. First, it was incorporated into the EU framework through the Treaty of Amsterdam, effectively making the Schengen Agreement and Convention part of the EU and part of the *aquis communautaire*. The Schengen Executive Committee was replaced by the Council of the EU, effectively reducing the influence of non-EU members like Norway, Switzerland and Iceland. Secondly, because some EU Members hold the opinion that Schengen does not go far enough in terms of information exchange as part of their fight against terrorism, in 2005 the five founding states (the Benelux countries, Germany and France) together with Spain and Austria, have negotiated a new parallel agreement, the Schengen III Convention (or: Convention of Prüm), aimed at improving such information exchange.

2. The Bologna Process

Another area in which parallel agreements play an important role, is that of higher education. Just as the Schengen Agreement was preceded by the Saarbrücken Agreement, the Bologna Declaration was preceded by the Sorbonne Declaration. In May 1998 the ministers of education of Germany, France, the United Kingdom, and Italy signed this Declaration, in which they called for a European Area of Higher Education in which the European higher education systems would be harmonized following the bachelor-master model. The

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5 For a constructivist explanation of the British 'No' to Schengen, see A. Wiener, "Forging Flexibility—The British 'No' to Schengen", 1 *European Journal of Law and Migration,* (1999), 441–463.

6 For an overview of the implementation difficulties see A. Convey and M. Kupiszewski, "Keeping Up with Schengen: Migration and Policy in the European Union", 29 *International Migration Review* (1995), 939–963.

Bologna Declaration, signed the following year (June 1999) by all EU-members and associated countries, contained an action plan defining clear goals on comparability of higher education systems, on employability and mobility of citizens involved in higher education, and on European cooperation in quality assurance, all to be reached in 2010.

The Sorbonne and Bologna Declarations were established on a strictly intergovernmental basis, outside the formal structure of the EU, with the European Commission being given an observer status. As De Wit[7] argues, this does not mean that the significance of the EU was not appreciated. The Bologna goals do largely coincide with the EU's objectives in higher education, on the basis of which, from the late 1980s onwards, a large number of programmes have been adopted—as part of the EU framework—that have similar goals: Comett, Erasmus/Lingua/Socrates, Tempus, Leonardo da Vinci, and the Jean Monnet project, all run by the European Commission. It was exactly the fear of Europeanisation of higher education through such programmes (using policy instruments as subsidies and legislation) that led Member States to take more voluntaristic initiatives based on information exchange, mutual learning, benchmarking, and peer review.[8] Pre-emption of Commission ambitions in the field of higher education clearly was a strong motive for the parties to the Sorbonne agreement.[9] Interestingly, the method chosen strongly resembles the EU open method of coordination which was introduced in the second part of the 1990s in employment and social policies.

The success of the 1998 Sorbonne Declaration was huge and several EU Member States complained that they had not been advised of the initiative. The 1999 Bologna Declaration thus had to involve far more countries and the first preparations for this Declaration were made at a meeting of Directors-General of Higher Education of all EU Member States, out of which grew a Steering Committee under the chairmanship of the then EU presidency, Austria. The financial support of the work of this committee by the European

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7 K. De Wit, "The Consequences of European Integration for Higher Education", 16 *Higher Education Policy,* (2003), 161–178.

8 See also E. Beukel, "Educational Policy: Institutionalization and Multi-Level Governance", in S. Anderson and K. Eliassen (ed), *Making Policy in Europe,* (London: Sage, 2001), 124–139; Bache, I., "The Europeanization of Higher Education: Markets, Politics or Learning?", 44 *Journal of Common Market Studies* (2006), 231–248.

9 J.K. Witte, Changes of Degrees and Degrees of Change. Comparing Adaptations of European Higher Education Systems in the Context of the Bologna Process (Enschede: CHEPS, 2006), at p. 90.

Commission shows that the Bologna Process had in fact taken place on the very edge of the EU framework rather than outside of it, and today it is increasingly linked to EU policies. However, its membership has proliferated beyond the EU: membership now includes 40 States, including the EU 25.

3. Corporate tax treaties

Another field in which alternative integration is an important feature is tax co-ordination. A complex and diverse pattern of tax co-ordination has developed in the EU, in which four major co-ordinating instruments can be made out:[10]

- directives and resolutions for harmonisation of taxes, and based on that the 'use' (especially by the Commission) of the Court of Justice to fight discriminatory taxation;
- multilateral agreements within the EU framework. Obviously, we are referring here to the use of the Code of Conduct for business taxation, on which the Ecofin Council agreed on 1 December 1997. This Code prevents the introduction of new fiscal measures that could influence the place of investment, such as a significantly lower effective level of taxation (including zero taxation) than that which generally applies in the Member States in question, granting special advantages to non-residents, different rules for calculating the profits of multinationals than the standard OECD ones, or the lenient application of tax regulations by the tax authorities. The Code of Conduct provides for a review process to determine which potentially harmful measures are actually harmful and have to be rolled back. For new measures there is a standstill clause: Member States are to refrain from introducing new harmful measures. Although the Code was conducted by the EU–15, and is formally not part of the *acquis communautaire*, in the accession treaties all new EU Member States have declared to live up to the Code[11];
- numerous bilateral agreements, outside the EU framework (tax treaties)[12];

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10 N.S. Groenendijk, "Tax Co-Ordination and the Enlargement of the European Union", 3 *Journal for Institutional Innovation, Development and Transition* (1999), 55–73.

11 Strictly speaking, because the Code is upheld EU wide, there is no sub-integration involved here.

12 See for instance the *IBFD European Tax Handbook 2005* for an overview. International Bureau of Fiscal Documentation, *European Tax Handbook* (Amsterdam: IBFD, 2006).

- multilateral agreements outside the EU framework, particularly within the OECD (and using OECD model tax treaties).

Of the above instruments the first one is used especially in indirect taxation (value added tax, excises), where the harmonisation efforts of the EU have been highly successful, as a prerequisite of the completion of the Single European Market (SEM). Tax harmonisation efforts in the field of direct taxation, especially corporate taxation, display a multitude of measures, reports, initiatives, Commission proposals, proposed Directives, draft Directives, preliminary draft Directives and such, the bulk of which were withdrawn later on.[13]

With corporate taxation a twofold problem of double taxation arises. First, corporate profits are taxed as company profits (through corporate income tax) as well as shareholders dividends (through personal income tax). Each Member State in the EU has dealt with this problem of double taxation differently. Most countries have some kind of dividend relief system, at the shareholder level (imputation system, tax credit system, or special personal income tax rate). Secondly, profits that are distributed to foreign investors (private investors, or foreign companies) may be taxed in the country where these profits arise as well as in the country the investor resides. Basically, company profits in the EU are taxed according to the origin or source principle, but what happens to repatriated profits is outside the field of vision of the source state. Even if the source state itself provides for an identical treatment of domestic and foreign investors, it has no say over the tax treatment of 'exported profits'.

Combined, these two double-taxation problems have proved to be insurmountable for the EU. Initially (in 1975) the European Commission aimed at eliminating double taxation on dividends through a full (i.e., base and rate) harmonisation of company tax systems. In 1990 these proposals were withdrawn for lack of support from Member States. The underlying problem is that imputation is more often than not offered to domestic shareholders only, which, of course, is discriminatory against foreign shareholders. Company taxes in the EU discriminate between (various kinds of) in-state and out-of-state investors and result in an arbitrary division of the company

[13] Apart from a Council Regulation on the application of social security schemes to individuals who choose to work in another Member State, the harmonisation of direct taxes in the EU has been confined to certain aspects of corporate taxation, more precisely to a. the withholding tax on dividends, b. the withholding tax on interest, and c. the taxation of groups of companies (including taxation of parent-subsidiary dividends).

income tax base between the state of investment and the state of the investor. A shift to the residence principle would solve this problem, but would mean that countries forgo the right to tax income arising within their own territory, i.e. forgo a considerable part of their "power to tax".

What has happened then is that EU Member States have resorted to bi— and multilateral tax treaties, i.e. to alternative measures of integration outside the EU framework. Such integration does not fundamentally deal with the basic problem of having 25 different corporate tax systems, but it does take the edge off the main negative effects of having all these different systems. This approach does however involve high transaction costs, as is shown by the extensive list of (often: bilateral) treaties (on dividends, on royalties, on interest) which EU Member States have concluded with other EU Member States and with third countries (see IBFD, 2006). Partly, these transaction costs are reduced by the use of model tax treaties provided by the OECD.

4. The European Patent Organisation

The last example of a parallel procedure is the European Patent Organisation (EPO). The EPO was preceded by the International Patent Institute (*Institut International des Brevets*, IIB), established in The Hague in 1947 by France and the three Benelux countries. Already in 1949 an EPO was advocated by the Council of Europe, modelled on the IIB. It would take until 1973 for the EPO to be established, by the Munich Convention on the Grant of European Patents. Currently, the EPO has 31 Member States, including 24 EU Member States (Malta is not yet a member of the EPO).

The EPO provides a single patent grant procedure, not a single European patent. An EPO-patent[14] can be obtained by filing a single application in one of the official languages of the European Patent Office (English, French or German) in a unitary procedure before the EPO and is valid in as many of the contracting states as the applicant cares to designate. An EPO-patent affords the same rights in the designated contracting states as a national patent granted in any of these states. But there is currently no single, centrally enforceable, EU-wide patent. This can be expensive for the patentee in that enforcement must be carried out through national courts in individual countries, and for a third party in that revocation cannot be accomplished centrally once a certain opposition period has expired. That is why, since the 1970s, there has been concurrent discussion towards the creation of a Community Patent (ComPat)

[14] Often the more confusing term 'European patent' is used, but not here.

in the European Union. The ComPat is intended to solve both of these problems, and also to provide a patent right that is consistent across Europe, thus fulfilling one of the key principles of the SEM (different patent rights in different countries present a distortion of the internal market principle). In May 2004, however, discussions within the EU led to a stalemate (the language issue being the most notable obstacle) and the prospect of a single EU-wide patent is receding. Even though the EPO-patent is far from perfect, there simply is no alternative available within the EU framework. Other legal agreements have been proposed—as with EPO: outside the EU legal framework—to reduce the cost of translation (of patents when granted) and litigation, namely the London Agreement (of 2000, signed by 10 countries, of which 7 are EU Members, but still waiting to be ratified) and the European Patent Litigation Agreement (EPLA, still under discussion).

5. The rationale for alternative integration

What do these four examples teach us about the pros and cons of alternative integration? Interestingly, it appears that alternative integration has more than one potential advantage. First, with parallel agreements it is possible to cover a larger part of Europe than just the EU–25 (or before 2004: the EU–15). Norway, Iceland, Liechtenstein and Switzerland are the "usual suspects" for cooperation outside the EU.

Secondly, alternative integration may be beneficial because the EU framework imposes all kinds of constraints (in terms of decision-making, legislation, democratic accountability et cetera). This should especially explain instances of alternative integration involving the entire EU.

Thirdly, in cases where not all EU Member States are involved, *inter se* agreements may be seen as a form of enhanced cooperation between a relatively small subset of Member States, but without using the EU enhanced cooperation mechanism. Lack of consensus in a specific policy field, or perceived differences in implementation capacity and speed, is at the root of this kind of alternative integration. As the Schengen and Bologna cases show, such alternative integration by a vanguard group can easily work as a catalyst for all EU Members, eventually spilling-over to the entire EU.

The main disadvantage of alternative integration is of course that with alternative integration the EU legal framework cannot be used, resulting in a relatively high level of transaction costs, both in terms of preparation and negotiation of a multitude of bilateral agreements as in terms of enforcement and uniform application.

The success of alternative integration can be seen in two different lights. On the one hand, manifold alternative integration to a certain extent is the result of failure of integration within the EU framework. If Member States cannot satisfactorily deal with policy problems inside the EU, they will start looking for alternative arrangements. On the other hand, alternative integration is sometimes perceived as a threat to the larger EU integration, and all kinds of possibilities for differentiated integration (within the EU institutional framework) have developed—especially since the Treaty of Maastricht—as an alternative to "alternative" integration. We will turn to this phenomenon in the next section.

IV. Differentiated Integration

The starting point to discuss differentiated integration (i.e., sub-integration within the EU institutional framework and policy domain) is the EU default mode of integration, which involves uniformity in time and matter, which can also be labelled monolithic integration or unitary integration. Common goals are set, EU wide, and are to be reached at a certain unique point in time by all Member States.

Departure from this default mode is possible along a number of dimensions:

1. Differentiation can refer to time only as opposed to differentiation in time and matter. Put differently: to what extent should sub-integration eventually be an exclusive thing? If there is differentiation in time only, common, EU-wide goals are retained but may be reached at different points in time by different Member States. Sub-integration in this sense is open to all, and indeed is successful only if eventually all members of the larger integration participate (after which the sub-integration is simply absorbed into that larger integration). If there is differentiation in time and matter, aiming at and attaining certain policy goals will be exclusive to the 'insiders';
2. Sub-integration may deal either with a single issue (or a few single, non-related issues) or with a multitude of (potentially interrelated) policy issues;
3. Sub-integration can differ as far as the size of the group of insiders is concerned (relative to the size of the group of outsiders);

4. The composition of the group of insiders can be steady across the range of policy areas in which sub-integration occurs, but can also vary (mixed coalitions);
5. Moreover, such coalitions can be more or less stable over time;
6. There can be a difference in influence in issues of the larger integration between those Member States inside and those Member States outside the sub-integration.

The closest thing to the default mode, i.e. unitary integration, is differentiation in time only, on a limited number of issues, and involving a limited number of outsiders. *Transitional arrangements, temporary derogations and/or exemptions* (to the *acquis communautaire*) are a clear example of this kind of sub-integration. Such differentiation has always been part of the Treaties (and of numerous Protocols) and of specific Community Directives. *Constructive abstention (declaratory abstention, positive abstention, active abstention)* is yet another possibility, restricted by the Treaty to specific measures taken as part of the Common Foreign and Security Policy.[15] With constructive abstention a Member State can simply declare that it does not support the decision taken and will not apply it itself, but accepts that the decision commits the Union.[16] Constructive abstention to a large extent resembles the more general idea of a (temporary and single-issue) *opt-out* clause, as for instance used by the United Kingdom and Denmark to be left out of the third stage of Economic and Monetary Union (EMU).[17]

If a larger number of Member States opt out, but these outsiders are still expected to catch up with the others at a later stage, such sub-integration can be labelled *multi-speed Europe (two-speed Europe, multi-speed integration).* Here the idea is that European integration is driven forward by a sub-group of Member States, but no Member State is excluded in the long run nor can Member States exclude themselves everlastingly. Differentiation is allowed to exist temporarily only. A special case of multi-speed is what German commentators call *abgestufte Integration.* Member States agree on particular

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15 Art. 23 TEU, see also Art. III–201 TCE.

16 If the members of the Council qualifying their abstention in this way represent at least one third of the Member States comprising at least one third of the population of the Union, the decision shall not be adopted.

17 In the EU opt-out clauses are generally reserved for incumbent members. Candidate countries are not being offered the opportunity to negotiate similar flexible arrangements; the European Council has made it clear on a number of occasions that new members will not be allowed opt-outs or others forms of flexible integration.

policy objectives, but specific timetables or stages of adoption by individual Member States are set. Differentiation is then a matter of (timing of) policy implementation rather than policy goals.

The multi-speed concept is rather similar to the idea of a *European vanguard group (avant-garde group, directoire, pioneers' clubs, pioneers and followers, pathfinders, breakaway riders).* Again, the final goal is to reach shared objectives, with the vanguard group braking ground and shaping these objectives along the way.

Other forms of differentiated integration presuppose that differentiation is not necessarily temporary. The idea of a *core Europe (Kern Europas, Harter Kern, noyau dur)* assumes a highly restricted membership of that core, which is (potentially) permanently limited. The core countries get engaged in far deeper integration than Member States outside the core. The latter do not longer constrain the former. The deeper integration does involve multiple related issues, and core countries do have a considerably larger overall influence than countries outside the core. The idea of a *two-tier Europe* is essentially the same, but uses another kind of visualization.[18] The related ideas of *concentric circles* (*cercles concentriques*) and of *multi-tier Europe (Europe de plusiers niveaux)* differ in that they presuppose the existence of more than just two groups (of insiders and outsiders).

Variable geometry (*géometrie variable*) is yet another concept of sub-integration. It also assumes a permanent state of sub-integration to be established, due to the fact that integrative capacities and desires will vary across the Union. Variable geometry envisages a series of different policy areas (on top of the internal market), all of which would have varying membership (or: policy consortia).[19] Contrary to the idea of a hard core, which puts a permanent set of Member States in the middle of integration, variable geometry starts from the internal market as core policy, around which various other policies have developed and will develop. This policy area configuration and the membership of the different policy consortia are however rather stable. The latter is not necessarily the case with *Europe à la carte (or: pick-and-choose, or: opt in/opt out)*. Moreover, the policy core here is not a full-fledged internal market but a common trading zone.

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[18] The same goes for concepts like magnetic fields, centre of gravitation, and hub-and-spoke Europe.

[19] The concept of eccentric ellipses (Gomes de Andrade) is one way of visualizing this variable geometry. N.N. Gomes de Andrade, "Enhanced Cooperation: the Ultimate Challenge of Managing Diversity in Europe", 40 *Intereconomics* (2005), 201–216.

Table 1 *Summarizes (and complements) the above*

Characteristics of different types of differentiated integration						
	Differentiation in time only or in time and matter?	**Single or multiple issues**	**Number and size of insider/outsider groups**	**Single <> mixed coalitions across policy areas**	**Stability of coalition(s) over time**	**Concentration of overall influence/power**
Transition periods, special treatments, derogations, exemptions, «differentiated Europe»	Time only	Single issue	Outsider group: small	–	–	–
Constructive abstention, declaratory/positive/active abstention	Time only	Single issue	Outsider group: small	-	–	–
Opt out arrangements	(In principle) time only	Single issue	Outsider group: small	–	–	–
Multi-speed Europe, multi-speed integration, two-speed Europe	(In principle) time only	Single or multiple issues	Insider and outsider groups: medium size	Single coalition	Stable	Powerful insiders
Abgestufte Integration	Time only	Single issue	Multiple groups, or individual implementation	–	–	–
European vanguard, avant-garde group, directoire, pioneers clubs, pioneers and followers, breakaway riders and pélotons	(In principle) time only	Single or multiple issues	Insider group: small	Mixed coalitions	Changing	No concentration of power

Table 1 *Summarizes (and complements) the above* (cont)

Characteristics of different types of differentiated integration						
	Differentiation in time only or in time and matter?	**Single or multiple issues**	**Number and size of insider/outsider groups**	**Single <> mixed coalitions across policy areas**	**Stability of coalition(s) over time**	**Concentration of overall influence/power**
Core Europe, Kern Europas, Harter Kern, noyau dur	In time and matter	Multiple issues	Insider group: small	Single coalition	Stable	Powerful insiders
Two-tier Europe, multi-tier Europe, plusiers niveaux	In time and matter	Multiple issues	Insider and outsider group: medium size	Single coalition	Stable	Powerful insiders
Concentric circles, cercles concentriques, magnetic fields, centre de gravité, centre of gravitation, hub-and-spoke Europe	In time and matter	Multiple issues	Multiple relatively small groups	Single coalitions	Changing	Powerful insiders
Variable geometry, géometrie variable, eccentric ellipses	In time and matter	Multiple issues	Multiple relatively small groups (policy consortia)	Mixed coalitions	Changing	No concentration of power
Europe à la carte, pick-and-choose, opt-in-opt out	In time and matter	Multiple issues	Multiple relatively small groups	Mixed coalitions	Changing	No concentration of power

The table clearly shows that the differences between the various forms of differentiated integration are gradual only, and it is hard to label actual examples of differentiated integration. EMU, for instance, can be considered as an example of two-speed Europe but resembles a vanguard group, involves opt outs, and can also be regarded as the current and future EU core.

Moreover, the difference between "odd integration" (defined in the previous section as integration within the EU framework but dealing with policies outside the EU competencies) and differentiated integration, rests on the assumption that there is a stable EU policy domain. But what may be odd integration at first, can easily become differentiated integration as views on what policy areas the EU should deal with evolve over time, possibly as a result of vanguard group activity.

Finally, not included in our discussion is the possibility of partial EU Membership and extended associations, which is of course close to the European core idea, or the idea of concentric circles.[20]

The different types of flexibility are obviously linked to certain views on how European integration should proceed, and in some cases can be linked to specific Member States. The idea of a Europe *à la carte* can be regarded as a mechanism to break federalist dynamism[21] and has been put forward in 1994 by then Prime Minister John Mayor.[22] Ideas like the *noyeau dur*, *géometrie variable*, and *cercles concentriques* have been advocated by French politicians (Delors, Mittérand, Balladur), assuming a Franco-German coalition at the heart and at the helm of Europe.[23]

As Su[24] observes, the need to seriously discuss differentiated integration became imminent due to the eastern enlargement of the EU. In his analysis,

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20 For a more detailed description of this—French—idea of different circles, with the outer circle consisting of EU partners rather than EU Members, see H. Su, "The Dynamics of Widening on the Deepening of the European Union—The Constitutionalization of Enhanced Cooperation", 35 *EURAMERICA* (2005), 501–545, at 524.

21 E. Philippart and M. Sie Dhina Ho, "Flexibility and the New Constitutional Treaty of the European Union", in J. Pelkmans, M. Sie Dhian Ho and B. Limonard (eds), *Nederland en de Europese grondwet* (The Netherlands and the European Constitution) (Amsterdam: Amsterdam University Press, 2003), pp. 109–154, at p. 110.

22 In his William and Mary Lecture given in Leiden, The Netherlands, in June 1994.

23 See Lansdaal, *supra,* note 2 for a more detailed discussion of joint Franco-German ideas in this field.

24 Su, *supra,* note 20.

partly building on Philippart and Sie Dhian Ho,[25] enlargement has been postponed time and time again, in order for the EU to reach consensus on mechanisms it could use to deal with diversity, which explains the emergence of opt outs, the increased importance of subsidiarity, the embracing in 2000 of the open method of policy coordination, and—last but not least—of enhanced cooperation. When it became clear, quite early in the process, that the central and eastern European countries would not content themselves with association agreements but wanted full EU Membership, and EU leaders—pressured by Germany—had to give enlargement the green light (in Copenhagen, June 1993), a new and formal mechanism had to be found to make differentiation between EU Members possible: "closer cooperation" or "enhanced cooperation".

V. Enhanced Cooperation

Enhanced cooperation can be seen as a specific mode of flexible integration, with a particular legal basis which regulates (and constraints) sub-integration within the EU.

Provisions regarding "closer cooperation" appear for the first time in the 1997 Amsterdam Treaty and were changed (now using the term "enhanced cooperation") by means of the Treaty of Nice (which became effective on February 1, 2003). In the draft Constitutional Treaty the Nice mechanism has been subjected to further changes.[26]

The closer cooperation mechanism of the *Treaty of Amsterdam* was a very cautious and rather general mechanism allowing a group of willing states to undertake closer cooperation among themselves while using the institutional mechanisms of the EU, but only if others would allow them to do so.[27] This mechanism was established in the first and third pillars, and contained an emergency brake procedure: the Council of Ministers had to

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25 Philippart and Sie Dhina Ho, *supra,* note 21.

26 Arts 43–45 TEU (substantive and procedural conditions in general), Arts 11 and 11a TEC (decisions on enhanced cooperation proposals in the first pillar), Art. 40 TEU (specific substantive conditions, second pillar), Arts 40a and 40b TEU (decisions on enhanced cooperation proposals in the second pillar), Arts 27a–27b TEU (specific substantive conditions, second pillar), Arts 27c–27e TEU (decisions on enhanced cooperation proposals in the third pillar). In the TCE enhanced cooperation is dealt with in Arts I–43 and III–321–329.

27 B. de Witte, "Future Paths of Flexibility: Enhanced Cooperation, Partial Agreements and Pioneer Groups", in J.W. de Zwaan, J.H. Jans and F.A. Nelissen (eds), *The European Union.*

decide on closer cooperation by qualified majority, but any Member State, for important and stated reasons of national policy, could refer the proposal to the European Council for a unanimous decision (constituting a *de facto* veto right). Furthermore, closer cooperation had to be endorsed by a majority of Member States (smaller groups were not allowed). The provisions of the Treaty of Amsterdam have never been used.

The *Nice Treaty* did away with the emergency brake procedure (in the first and third pillar) and extended enhanced cooperation to the second pillar (CFSP) but with an emergency brake (i.e. veto) procedure. In the first and second pillar proposals for enhanced cooperation (put to the Council by the European Commission following a request from the Member States involved) are subject to a qualified majority vote. The number of Member States required for launching the procedure has changed from the majority to the fixed number of eight Member States.

Under the Nice Treaty enhanced cooperation is subject to a number of conditions, both substantive and procedural.

The *substantive conditions* can be clustered as follows (following Philippart).[28] First, there are conditions specifying *what enhanced cooperation should aim at*. It should aim at furthering the objectives of the Union, at protecting and serving EU interests, and at reinforcing the process of European integration. Secondly, there is a list of *what enhanced cooperation may not entail in light of the Union's cohesion and internal coherence.* Enhanced cooperation must respect the Treaties and the single institutional Union framework. It must not affect the *acquis communautaire* and must respect the whole of the Union's policies. It must not undermine the internal market or economic and social cohesion. Thirdly, several conditions deal with the *protection of Member States not participating in the enhanced cooperation*. Enhanced cooperation must respect the competences, rights, and obligations of the outsiders. It must not constitute a barrier to or discrimination in trade and must not distort competition. Fourthly, it is stated in which areas enhanced cooperation is simply *forbidden*. Enhanced cooperation is prohibited were the Union has no powers. It is prohibited in fields under

An Ongoing Process of Integration, (The Hague: TMC Asser Press, 2004), pp. 141–153, at p. 145.

[28] E. Philippart, "Optimising the Mechanism for 'Enhanced Cooperation' within the EU: Recommendations for the Constitutional Treaty"(CEPS Policy Brief No. 33, Brussels: CEPS, May 2003).

the exclusive competence of the Union, and (within the second pillar) it must not have any military and defence implications.

The *procedural conditions* are as follows. There is a participation threshold of eight Member States. Enhanced cooperation is a last resort (i.e. when it has been established within the Council that the objectives of such cooperation cannot be attained within a reasonable period by applying the relevant provisions of the Treaties). And there is openness of enhanced cooperation to all EU Member States, at all times, with participation to be encouraged by the Commission and by the Member States already engaged in enhanced cooperation.

Decision-making within enhanced cooperation unions is envisaged as follows. All EU Members are able to take part in deliberations, but only enhanced cooperation union members shall take part in adoption of decisions. The same decision rules (qualified majority rule, unanimity) and procedures (including Commission and EP involvement) apply as in the Union at large. Acts adopted and decisions taken within enhanced cooperation unions shall not become part of the Union *acquis* (which new Member States must adopt). They are not binding on the outsiders. Expenditure resulting from enhanced cooperation (other than administrative costs) will be borne by the insiders only.

The *Draft Constitution* has stripped the enhanced cooperation mechanism of some of the conditions mentioned above (which by some were largely considered to be superfluous anyway),[29] but most provisions have been retained, albeit rephrased[30]:

- enhanced cooperation should aim at furthering the objectives of the Union, at protecting its interests, and at reinforcing the process of European integration;
- it should be established within the framework of the Union's non-exclusive competences;
- it may make use of the Union's institutions;
- it shall comply with the Union's Constitution and law. It is however possible for the Member States engaged in enhanced cooperation to

[29] E. Philippart, "A New Mechanism of Enhanced Co-Operation for the Enlarged European Union" (Research and European Issues No. 22, Paris: Notre Europe, March 2003); and Philippart, *supra,* note 28.

[30] We refrain here from discussing the special provisions for enhanced cooperation in the area of CFSP as the focus in this paper is on tax matters.

decide (unanimously) to take decisions by qualified majority even if in the specific area unanimity is the rule;

- it should be open at all times to all EU Member States;
- it is a last resort (i.e. it has to be established within the Council that the objectives of such cooperation cannot be attained within a reasonable period by the Union as a whole);
- a participation threshold applies of one-third of all Member States (rather than the fixed number of eight Member States);
- all EU Members are able to take part in deliberations, only enhanced cooperation union members shall take part in the vote;
- acts adopted and decisions taken within enhanced cooperation unions shall not become part of the Union *acquis* (which new EU Member States must adopt upon accession). They are not binding to the outsiders, but EU Members wishing to join the enhanced cooperation at a later stage have to adopt the enhanced cooperation *acquis*;
- it must not undermine the internal market nor economic, social and territorial cohesion, nor distort competition;
- enhanced cooperation must respect the competences, rights, and obligations of the outsiders;
- expenditure resulting from enhanced cooperation (other than administrative costs) shall be borne by the insiders only;
- the Council grants authorization to proceed with enhanced cooperation by a European decision, upon a proposal from the Commission, and after obtaining the consent of European Parliament. The Council decides by qualified majority;
- under the draft Treaty it is possible for States engaged in enhanced cooperation to set aside the unanimity rule for decision making in areas such as direct taxation and social policy, and take decisions using a qualified majority rule.

Both under the Nice Treaty and the draft Constitutional Treaty an important role is played by the European Commission.[31] First, the Commission is to pass a request for enhanced cooperation to the Council by

[31] See Federal Trust, *supra,* note 2, for a discussion of the possible functioning of some other institutions under flexibility.

means of a Commission proposal. Secondly, the Commission vets any later applications of Member States wanting to join the sub-group.

VI. Possibilities for Enhanced Cooperation: The Case of Corporate Tax Coordination

As was shown in section three, corporate taxation is a field where alternative integration is prospering, by means of bi—and multilateral tax treaties. It is also one of the policy areas for which enhanced cooperation is often seen as a way out of the current decision-making deadlock.

First, enhanced cooperation could be used to fight fiscal dumping. Fiscal dumping refers to the practice of setting low (effective) tax rates in order to attract foreign (direct) investment. Within the EU–15, fiscal dumping was practiced in the field of corporate taxation by Ireland only. As such it was a minor inconvenience. However, within the EU–25, most new Member States have very low effective corporate income tax rates. In 2004 France and Germany proposed the use of enhanced cooperation to fight (excessive) corporate tax competition, by establishing a single corporate tax zone, initially in France, Germany, Belgium and Spain only.[32] Within this zone there would be a single corporate tax, with a single base and rate. In this way the countries within the zone would be able to compete with countries outside the zone (by reducing transaction costs for companies operating within the zone), and competition within the zone would be minimized.

Secondly, enhanced cooperation has been put forward as a way to deal with the proliferation of the corporate income tax system within the EU. With EU wide direct tax harmonisation having been put "on the back burner" (a line of action taken by former Commissioner Bolkestein and endorsed fully by current Internal Market Commissioner McCreevy, but less so by Taxation Commissioner Kovács), enhanced cooperation may well be the only way left to deal with issues of direct tax coordination in the EU, also because direct taxation is still subject to unanimity voting in the Council.[33] The only new development in recent years has been the idea the

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[32] *European Voice,* May 27-June 2, 2004, p. 7. In subsequent proposals made by France the eligibility of EU Member States for EU structural funds support was linked to membership of the corporate tax zone.

[33] Earlier pleas for the use of enhanced cooperation in taxation were made regarding environmental taxation, from 1999 onwards, by the European Commission, by European Parliament, by some Member States (The Netherlands), and in academic circles. In 2004

Commission came up with in 2001 of a Common Consolidated Corporate Tax Base (CCCTB). This CCCTB can be used by companies involved in cross-border activities within the EU to calculate their taxable profits and the apportionment of these profits over the Member States involved. Within this system Member States are free to apply their own corporate tax rate to their portion of company profits. Although often presented as a harmonisation scheme, the CCCTB actually is an optional 26th system next to 25 systems already in place. It is up to companies to decide whether they want to use the CCCTB or not (in the latter case they can still use the national systems). The Commission is currently aiming to get the CCCTB introduced by the end of 2008.[34] Initially, the Commission expected the idea of a CCCTB to be supported by around 20 Member States[35], but apparently the idea is currently supported only by Austria, France, Belgium, Germany, Luxembourg, Italy, and Hungary. Most Member States are hesitant, and some are outright opponents of the idea: the United Kingdom, Ireland, the Baltic States, Slovakia and Slovenia.[36] Commissioner Kovács has argued that the idea will be sustained, if need be, using the enhanced cooperation mechanism.

Suppose that a sub-set of EU countries would indeed engage in further corporate tax coordination, within the enhanced cooperation framework (hereafter labelled: ECUCT, Enhanced Cooperation Union for Corporate Taxation). Such coordination could entail:

- full base and rate harmonisation of their corporate tax systems (A);
- base harmonisation only (B);
- introduction of a CCCTB next to the corporate tax systems already in place (C).[37]

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a common Nordic approach in the EU (and including non-EU Member Norway) was suggested to deal with the cross-border shopping effects of alcohol excise differentials between Norway, Sweden, Finland, Estonia, Denmark, Germany, and Poland (EUObserver.com, Oct. 20, 2004).

34 European Commission, "Implementing the Community Lisbon Programme: Progress to date and next steps towards a Common Consolidated Corporate Tax Base (CCCTB)" (Brussels: European Commission, COM (2006) 157 final, April 2006), at 8.

35 EurActiv.com, Wednesday Oct. 26, 2005.

36 *European Voice*, April 13–19, 2006, at 7.

37 A CCCTB would necessitate formula appointment of taxable profits. For an analysis of the specific economic effects of formula appointment. P.B. Sørensen, "Company Tax Reform in the European Union", 11 *International Tax and Public Finance* (2004), 91–115.

What would the effects of such cooperation be?

First, in all cases (A, B and C) we would expect a reduction of transaction costs for companies already operating across borders within the ECUCT. As such compliance costs are a deadweight loss to companies, such reduction represents a straightforward welfare gain for companies involved, which—in a competitive environment—should translate into lower prices and welfare gains for consumers.

Secondly, high compliance costs do not only represent a deadweight loss, they also operate as a barrier to trade. Cross-border economic activities within the ECUCT are expected to increase with harmonisation.

Thirdly, if cross-country differences in effective tax rates would be reduced (which may happen to a certain extent in cases B and C, and fully in case A), this will lead to a more efficient allocation of capital across the ECUCT.[38] Jensen and Svensson have shown that this effect is indeed larger with full harmonisation than with just tax base harmonisation.[39]

Fourthly, harmonisation of effective tax rates (due to base or base plus rate harmonisation) will increase the tax burden in some ECUCT members and decrease the tax burden in other countries. A larger tax burden will result in higher tax revenues at a lower GDP; a lower tax burden will result in lower tax revenues at a higher GDP. Jensen and Svensson have made estimations of the effect of enhanced cooperation with full corporate tax harmonisation (our case A), between respectively the "old" EU–15, Eurozone and a EU–11-group.[40] If these groups are expected to harmonize their tax rate on 31%, 31.5% and 33% respectively (based on unweighted averages of current rates), this implies losses in GDP and gains in tax revenues. If harmonisation takes place using weighted averages of current rates there is an increase in GDP and a loss of tax revenues. The magnitude of these effects depends largely on the effect enhanced cooperation will have on Germany. Germany currently has a high corporate tax rate. At the same time, Germany has a very low ratio of corporate tax revenues to GDP. Any harmonisation of corporate

38 Sørensen, *supra,* note 37.

39 J. Jensen and P. Svensson, "Economic Effects of Tax Cooperation in Enlarged European Union. Simulations of Corporate Tax Harmonisation and Savings Tax Coordination" (Brussels: European Commission, DG Taxation and Customs Union (Copenhagen: Copenhagen Economics, Oct. 2004).

40 Consisting of Austria, Belgium, Finland, France, Germany, Greece, Italy, Luxembourg, Portugal, Spain and Sweden. According to Jensen and Svensson, this grouping is based on common views on tax accounting issues. Jensen and P. Svensson, *supra,* note 39.

tax bases will drastically increase the German base, and will lead to a sharp increase in the ECUCT tax burden, regardless of the composition (as long as Germany is in). To reach positive GDP effects harmonisation should take place in such a way that the full magnitude of the largest economy in Europe is taken into account.

Fifthly, ECUCT members will suffer welfare losses due to distortion of their individual taxation preferences, which have to make way for collective ECUCT preferences. These preferences concern the overall importance of the corporate income tax in the national tax system and the size and level of base and rates, but also very specific corporate tax system features (tax facilities, loopholes), aimed at promoting certain activities (green investments, company child care et cetera).

Sixthly, the ECUCT could induce negative externalities on EU Members outside the ECUCT,[41] in terms of undermining the internal market, thwarting economic, social and territorial cohesion, and distorting competition. Although these possible negative effects are often mentioned (and, as was shown in section V, constitute a formal barrier to establishing enhanced cooperation), there is no economic analysis available to make further inferences as to their likelihood and magnitude.

Another possibility is a positive externality: the ECUCT will pave the way for the countries temporarily left behind. These countries can benefit from the experimentation and learning on the pros and cons of cooperate tax harmonisation by the ECUCT member.[42]

The possibility that enhanced cooperation in one field, by one group of countries, will extend to other areas and will thus benefit other countries has been put forward by, among others, Baldwin[43] who uses the term "domino effect", Pisany-Ferry[44] who speaks of a "centripetal force" and Gomes de Andrade[45] who uses the term "pull effect".

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41 M. Dewatripont a.o., "Flexible Integration: Towards a More Effective and Democratic Europe" (London: CEPR, 1995).

42 *Ibid.*

43 R.E. Baldwin, "A Domino Theory of Regionalism" (NBER Working Paper No. W4465, *Cambridge: NBER*, September 1993).

44 J. Pisany-Ferry, "L'Europe à géometrie variable: une analyse économique", 60 *Politique Étrangère* (1995), 447–465.

45 *Supra,* note 19.

Besides this, it may well be that those Member States that do not wish to participate will do so because they feel their tax systems in specific areas should be more 'tax-payer friendly' than the ECUCT allows for; outsiders can choose to remain outside the ECUCT for reasons of tax competition.

Seventhly, there is a first-mover advantage. Bordignon and Brusco[46] have argued that the effects of enhanced cooperation should be assessed in a dynamic and stochastic context. Stochastic refers to the possibility that countries that may not want to join the ECUCT at t_1 may decide to do so at t_2. Dynamic refers to the influence of t_1 on t_2: what happens today is going to affect what happens tomorrow. Their argument is that even with no negative externalities taking place as such at t_1 or at t_2, enhanced cooperation may induce a welfare loss on outsiders because the first movers set the example which second movers must follow. In that way a relatively homogeneous but small group of countries can enforce their preferences on the larger group. The Treaty provisions, which were discussed in section V, indeed enable first movers to create the *acquis*. Suppose that the ECUCT consists of countries with relatively high tax rates only (including Germany, France), and with the establishment of enhanced cooperation a common relatively high corporate tax rate is established based on (weighted) averages of the participating countries. Any other country wishing to join the ECUCT at a later stage will be confronted by the need to sharply increase its rate. What goes for the initial choice of rates goes for all other choices the ECUCT makes on system and base issues as well. Of course the EC Treaty to a certain extent deals with this problem by allowing outsiders to take part in the deliberations within the ECUCT and by endowing the Commission (and to a lesser extent European Parliament) with the task of guarding the interests of all EU Member States.

Finally, one of the fears in this regard is that enhanced cooperation may lead to a permanent divide between insiders and outsiders, between a rich core and a poor periphery. Martin and Ottaviano[47] argue that the outcome will probably depend on the level of labour mobility. If capital is foot-loose and labour is sticky, the analysis of the effects of a reduction of transaction

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46 M. Bordignon and S. Brusco, "On Enhanced Cooperation" (*CESinfo* Working Paper No. 996, Munich: *CESinfo,* July 2003); M. Bordignon, "Institutional aspects of EU organization: an economic analysis" (paper prepared for the CESifo-Delphi 2004 Conference, January 2005).

47 P. Martin and G. Ottaviano, "The Geography of Multi-Speed Europe" (CEPR Discussion Paper No. 1292, London: CEPR, Nov. 1995).

costs within the enhanced cooperation zone can be limited to the issue of re-location of firms in relation to income convergence/divergence. If there is a tendency to re-locate from the outside to the inside of the enhanced cooperation zone, outsiders will suffer an initial economic blow, will have to catch up and have to think about the proper timing (in terms of income convergence) of joining the club. If labour is mobile as well, permanent divergence of incomes is likely, which Martin and Ottaviano have labelled the "agglomeration effect of multi-speed integration".[48]

Table 2 *Summarizes the possible effects*

Possible effects of enhanced cooperation in corporate taxation		
Range of effect	**Effect**	**Positive/negative**
Within ECUCT	Reduced deadweight loss in company tax compliance costs	+
	Increased trade	+
	More efficient allocation of capital	+
	GDP change <> tax revenue change, due to harmonization of base/rate	+/-, but differences between participants
	Preference distortion	-
Effect vis-à-vis outsiders	Negative externalities	- for outsiders
	Positive externalities	+ for outsiders
	First-mover advantage	+ for insiders ;—for outsiders
	Agglomeration effect	+ for insiders ;—for outsiders

VI. CONCLUSIONS

Although some of the effects discussed above are particular to the case of an ECUCT, some more general conclusions can be made based on the analysis of possibilities for enhanced cooperation in corporate taxation.

First, alternative (sub-) integration is currently the main way of dealing with direct tax coordination problems by EU Member States but also

[48] *Ibid.*

in some other areas (higher education, immigration policy, patents). Given the substantive and procedural requirements for enhanced cooperation, this approach remains valid, even with these requirements having been relaxed by the Nice Treaty (and by the draft Constitutional Treaty). Countries interested in pursuing the idea of—for instance—a CCCTB could relatively easily either engage in an *inter se* formal agreement (multi-lateral tax treaty) or use the Code of Conduct instrument. As was shown in section three, alternative integration can be used as a means of *de facto* enhanced cooperation, without bothering with the formal Nice requirements. However, with formal enhanced cooperation it is possible to use the EU legal framework for preparation, adoption and uniform enforcement of legislation.

Secondly, the actual size and composition of the initial enhanced cooperation is of great importance, as the balance of benefits (in terms of reduced transaction costs, increased welfare) and costs (in terms of distortion of country-specific preferences) depends largely on these two elements. The larger the enhanced cooperation the larger the effect is in terms of reduced transaction costs. The more homogeneous the enhanced cooperation is, the better it is in terms of limiting preference distortion. But of course these two elements are often inversely related: the larger the cooperation, the more heterogeneous it is. Enhanced cooperation is about finding an "optimal policy area".[49]

Finally, enhanced cooperation under the Nice Treaty (as well as under the draft Constitutional Treaty) creates a partial *acquis* resulting in a first-mover advantage. On the one hand, such an advantage could be an incentive for hesitant Member States to participate in the enhanced cooperation from day one, or even to promote direct moves forward for the EU as a whole without actual enhanced cooperation taking place. This may explain the recent successful use of the enhanced cooperation mechanism as a threatening device in the case of the European Arrest Warrant and the Bolkestein Directive. On the other hand, the first-mover advantage creates rigidity at later stages. One of the main advantages of the enhanced cooperation mechanism over alternative integration is precisely that enhanced cooperation is open to all Member States at all stages. In that way first movers can pull the laggards in the right direction. But if accession to the enhanced cooperation at later stages is very difficult due to an enhanced cooperation *acquis* that deviates too much from the mean EU position, this advantage is imaginary only. It should therefore be made possible to make the partial *acquis* negotiable upon accession to the enhanced cooperation by newcomers.

[49] Cf. the idea of an "optimal currency area" in monetary integration.