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EUROPE WITH TWO FISCAL SPEEDS:
THE WEAKNESSES OF EUROPEAN REGULATION

A Comparative Analysis of High Tax and Competitive Tax Models

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To every *carpe diem*,

and to every handshake that shapes my destiny.

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ABSTRACT

This thesis examines the persistence of divergent fiscal models within the European Union and explains why the EU increasingly operates according to "two fiscal speeds." While the Single Market and the Economic and Monetary Union have fostered a high degree of economic integration, fiscal policy remains largely under national control. This institutional asymmetry has enabled different tax regimes, welfare systems, and budgetary strategies to coexist, generating structural differences in competitiveness, economic resilience, and institutional capacity across member states.

The analysis traces the evolution of EU fiscal governance, explores the mechanisms of intra-EU tax competition, and identifies the structural drivers of divergence between high-tax coordinated economies and competitive-tax models. A comparative framework focusing on Italy and Germany, on the one hand, and Ireland and the Netherlands, on the other, highlights how distinct fiscal choices shape long-term economic trajectories, welfare outcomes, and bargaining power within the EU.

The central argument of the thesis is that fiscal divergence is not a temporary imbalance but a structural feature embedded in the institutional design of the Union. The coexistence of heterogeneous fiscal models is sustained by both economic incentives and legal constraints, making convergence difficult within the current framework.

In this perspective, the thesis anticipates its main conclusion: without a reconfiguration of EU fiscal governance, the coexistence of two fiscal speeds is likely to persist. Addressing this divergence requires moving beyond incremental

regulatory adjustments toward a more coherent alignment between market integration and fiscal coordination.

More fundamentally, the analysis suggests that the issue of fiscal divergence reflects a broader constitutional tension within the European integration process. As long as economic integration continues to deepen without a corresponding evolution in fiscal authority, structural asymmetries are likely to be reproduced rather than resolved. The challenge is therefore not only technical or regulatory, but inherently political and institutional.

Ultimately, the future of EU fiscal governance depends on a strategic choice between maintaining a decentralised equilibrium that tolerates divergence, and progressively strengthening fiscal coordination to ensure greater coherence between integration, equity, and stability. In this sense, overcoming Europe's two fiscal speeds is not merely a policy objective, but a necessary condition for the long-term sustainability and legitimacy of the European project.

SINTESI

La presente tesi analizza la persistenza di modelli fiscali divergenti all'interno dell'Unione Europea, interpretando il progressivo consolidarsi di una struttura a "due velocità fiscali" come esito coerente dell'assetto istituzionale europeo. Nonostante il Mercato Unico e l'Unione Economica e Monetaria abbiano prodotto un elevato grado di integrazione economica, la sovranità fiscale rimane prevalentemente nazionale. Questa asimmetria tra integrazione dei mercati e frammentazione delle competenze fiscali ha consentito la coesistenza di differenti regimi fiscali, sistemi di welfare e strategie di bilancio, generando divari strutturali in termini di competitività, resilienza economica e capacità istituzionale tra gli Stati membri.

La tesi ricostruisce l'evoluzione della governance fiscale europea, analizza i meccanismi della concorrenza fiscale intra-UE e individua i fattori strutturali che sostengono la divergenza tra economie ad alta tassazione e coordinamento istituzionale e modelli fiscali competitivi. Attraverso un'analisi comparativa tra Italia e Germania, da un lato, e Irlanda e Paesi Bassi, dall'altro, il lavoro evidenzia come differenti configurazioni fiscali producano traiettorie divergenti in termini di crescita economica, sostenibilità del welfare e capacità di influenza nei processi decisionali europei.

L'argomento centrale della tesi è che la divergenza fiscale non rappresenti una deviazione temporanea, ma una componente strutturale dell'integrazione europea, sostenuta da incentivi economici e vincoli giuridici che ne rafforzano la persistenza nel tempo. In questa prospettiva, le "due velocità fiscali" non emergono come un'anomalia del sistema, bensì come una manifestazione coerente della sua logica interna.

In tale quadro, la tesi anticipa il proprio esito principale: in assenza di un riallineamento tra integrazione economica e coordinamento fiscale, la divergenza è destinata a riprodursi. Affrontare questo squilibrio richiede quindi di superare interventi regolatori incrementali, orientandosi verso un maggiore allineamento tra il grado di integrazione dei mercati e gli strumenti di governance fiscale.

Più in profondità, l'analisi evidenzia come la divergenza fiscale rifletta una tensione di natura costituzionale nel processo di integrazione europea. Finché l'integrazione economica continuerà ad avanzare senza un corrispondente sviluppo della capacità fiscale a livello europeo, le asimmetrie strutturali tenderanno a persistere. La questione non è dunque soltanto tecnica o regolatoria, ma intrinsecamente politica e istituzionale.

In ultima analisi, il futuro della governance fiscale europea dipende da una scelta strategica tra il mantenimento di un equilibrio decentralizzato, che accetta la coesistenza di due velocità fiscali, e un progressivo rafforzamento del coordinamento fiscale, volto a garantire maggiore coerenza tra integrazione economica, equità distributiva e stabilità. In questo senso, il superamento delle due velocità fiscali non rappresenta soltanto un obiettivo di policy, ma una condizione essenziale per la sostenibilità e la legittimità di lungo periodo del progetto europeo.

INTRODUCTION

The European Union (EU) represents the most advanced attempt at regional economic integration in modern history. Built upon a progressive deepening of economic interdependence, the EU has sought to combine market integration with coordinated governance frameworks capable of sustaining stability, competitiveness, and social cohesion across diverse national economies. Yet, despite decades of integration, significant divergence persists among member states, particularly in the field of fiscal policy. These divergences manifest not only in tax structures and revenue models, but also in broader economic performance, welfare capacity, institutional strength, and compliance with EU rules. As a result, scholars and policymakers increasingly describe the Union as characterised by **"two fiscal Europes"**, one centred on high-tax, high-welfare, coordinated economies, and the other on competitive-tax models that leverage low rates and regulatory flexibility to attract investment.

This thesis investigates the origins, mechanisms, and implications of this duality. While European integration has progressively expanded the scope of common rules, especially in monetary, trade, and competition policy, fiscal policy has remained largely under national control. The Treaties deliberately restrict the EU's competence in taxation, leaving space for national strategies that often diverge sharply. These structural constraints have allowed forms of fiscal competition to emerge within the Single Market, contributing to asymmetric outcomes among member states. The financial crisis of 2008, the sovereign debt crisis, and the subsequent decade of austerity further intensified these divergences, especially between Northern and Southern Europe.

Conversely, the introduction of the Recovery and Resilience Facility after the COVID-19 shock demonstrated both the potential and the limits of deeper fiscal coordination.

Understanding how and why fiscal divergence persists, and how it shapes Europe's economic and political landscape, is essential for assessing the strengths and weaknesses of current EU regulation. By comparing high-tax coordinated models, exemplified by Germany and Italy, with competitive-tax models such as Ireland and the Netherlands, this thesis aims to reveal the structural dynamics that underpin Europe's "two fiscal speeds."

The analysis explores not only fiscal indicators, but also economic performance, welfare outcomes, institutional capacity, and the interaction between national strategies and EU-level governance.

Ultimately, this research contributes to the broader debate on the future of European integration. Persistent fiscal asymmetry poses challenges for fair competition, cohesion, and democratic legitimacy within the Union. However, recent reforms, including new macroeconomic governance proposals and the experience of joint borrowing, offer opportunities for rethinking the balance between national autonomy and collective responsibility. By examining both the historical evolution and contemporary manifestations of fiscal fragmentation, the thesis provides a foundation for evaluating the weaknesses of EU regulation and identifying pathways toward a more integrated and sustainable fiscal framework.

Chapter 1: The European Union and Fiscal Regulation

1.1 The Origins of European Economic Integration

The origins of European economic integration are rooted in the political and economic reconstruction that followed the Second World War, when European governments recognised that lasting peace and sustainable development required new forms of cooperation. The devastation of the conflict had weakened national economies, disrupted trade, and exposed the risks of protectionist policies that had contributed to instability in the interwar period. In this context, the idea that prosperity and security could be achieved only through economic interdependence became widely accepted. Integration was therefore conceived as both an economic strategy and a political project aimed at preventing the re-emergence of rivalries among European states.

The first concrete step toward this goal was the creation of the European Coal and Steel Community (ECSC) in 1951. By pooling the production of coal and steel key sectors for industrial and military capacity, the ECSC established a supranational framework that encouraged transparency, cooperation, and shared oversight. Its success demonstrated that common institutions could effectively manage cross-border economic activities, providing a foundation for more ambitious forms of integration. Building on this experience, the Treaty of Rome in 1957 established the European Economic Community (EEC), with the objective of creating a common market based on the free movement of goods, services, capital, and labour. This marked a decisive shift from sectoral coordination toward a broader vision of economic unity and regulatory harmonisation.

During the 1960s and 1970s, integration progressed through the completion of the customs union, the development of common agricultural policies, and the first efforts to coordinate monetary policy. Although global economic shocks created uncertainty and slowed the pace of integration, they also reinforced the argument that European economies needed stronger mechanisms of cooperation to withstand external pressures. These early institutional developments laid the groundwork for later breakthroughs, including the completion of the Single Market in 1992 and the establishment of Economic and Monetary Union. Both initiatives significantly deepened integration by removing internal barriers, expanding regulatory alignment, and introducing new forms of shared governance.

The origins of European economic integration therefore reflect a gradual but transformative process driven by political ambition and economic necessity. While the project initially sought to secure peace and stability, it evolved into a comprehensive framework aimed at enhancing competitiveness, supporting economic modernisation, and strengthening Europe's position in the global economy. However, the early design of integration also created structural asymmetries: trade, competition, and monetary policy became increasingly centralised, whereas fiscal policy largely remained under the authority of national governments. This institutional imbalance would later play a crucial role in shaping divergent fiscal strategies among member states, contributing to the emergence of what is now described as Europe's "two fiscal speeds."

1.2 The Evolution of EU Fiscal Governance

The evolution of EU fiscal governance reflects the broader tension between deepening economic integration and the persistent primacy of national sovereignty in taxation and budgetary policy. From the beginning of the European project, fiscal matters remained largely outside the scope of supranational authority. The Treaties emphasised market integration, competition policy, and monetary coordination, while leaving taxation and public spending to the discretion of member states. As a result, fiscal governance developed incrementally, often in response to economic shocks or institutional gaps exposed during moments of crisis.

In the early decades of integration, fiscal coordination was limited. The European Economic Community relied primarily on soft mechanisms, such as consultations and recommendations, to encourage macroeconomic stability. This approach reflected the belief that a functioning common market did not require centralised fiscal authority and that national governments were best positioned to manage their own budgets. However, as economic interdependence increased, the limitations of this model became more apparent. The completion of the Single Market intensified cross-border spillovers, and growing monetary cooperation raised questions about the consistency of fiscal policies across member states.

A turning point came with the creation of Economic and Monetary Union (EMU), which introduced the euro and required new rules to ensure fiscal discipline within a shared monetary framework. The Stability and Growth Pact (SGP), adopted in the late 1990s, established quantitative limits on government deficits and public debt. It represented the first attempt to formalise fiscal governance at the EU level, although enforcement remained politically sensitive and often uneven. The pact was revised several times in the following years to address criticisms that it was either too rigid or too weak, reflecting the difficulty of balancing market confidence, flexibility, and national autonomy.

The global financial crisis of 2008 and the subsequent sovereign debt crisis exposed fundamental weaknesses in the EU's fiscal architecture. These crises revealed that the combination of integrated financial markets, a common monetary policy, and decentralised fiscal authority created vulnerabilities that existing rules could not adequately address. In response, the EU adopted a series of reforms aimed at strengthening fiscal surveillance and coordination. These included the “Six-Pack” and “Two-Pack” regulations, the Fiscal Compact, and new monitoring instruments designed to detect macroeconomic imbalances. Although these measures significantly expanded the EU’s role in fiscal oversight, they did not alter the basic principle that taxation and spending decisions remain national prerogatives.

Recent developments have prompted renewed debate about the future of fiscal governance. The introduction of the Recovery and Resilience Facility (RRF) in 2021 marked a historic shift by enabling joint borrowing and linking financial support to national reform strategies. This temporary mechanism demonstrated the potential for more integrated fiscal responses to common economic challenges, but also highlighted the political and institutional constraints that continue to limit deeper coordination. Ongoing discussions about reforming the Stability and Growth Pact illustrate the difficulty of designing rules that promote both fiscal sustainability and economic convergence in a highly heterogeneous union.

Overall, the evolution of EU fiscal governance shows a gradual movement from informal coordination to more structured and rules-based oversight. Yet the system remains fundamentally hybrid: supranational institutions play a significant role in surveillance and guidance, while member states retain decisive control over taxation and public finances. This asymmetry remains one of the key structural factors behind the emergence of divergent fiscal models within the EU and contributes to the broader phenomenon of Europe’s “two fiscal speeds.”

1.3 The Role of the Treaties (TFEU, Maastricht, Lisbon)

The architecture of the European Union’s fiscal governance is fundamentally rooted in the constitutional framework established by the Treaties. While the Union pursues the objective of creating an integrated internal market and promoting economic cohesion, as stated in **Article 3 TEU**, the allocation of competences reveals a deliberate asymmetry between monetary and fiscal integration.

The Maastricht Treaty (1992) marked a decisive turning point by establishing the Economic and Monetary Union (EMU). Through what is now codified in **Articles 121 and 126 TFEU**, it introduced mechanisms for multilateral surveillance and the Excessive Deficit Procedure, aiming to ensure fiscal discipline among Member States. However, while monetary authority was centralised under the European Central Bank, fiscal sovereignty remained national. This reflects the principle of conferral enshrined in **Article 5 TEU**, according to which the Union acts only within competences explicitly attributed to it.

The Treaty of Lisbon (2009) further clarified this distribution of powers. Taxation was not transferred to the Union as an exclusive competence; rather, it remains largely within Member State authority, subject only to limited harmonisation where necessary for the functioning of the internal market. Under **Article 113 TFEU**, the EU may harmonise indirect taxation (notably VAT and excise duties), while **Article 115 TFEU** allows approximation of laws affecting the internal market, both requiring unanimity in the Council. This unanimity requirement has significantly constrained deeper fiscal integration.

At the same time, the Treaties establish robust supranational control in adjacent domains. The internal market framework under **Article 26 TFEU**, the prohibition of discriminatory taxation in **Article 110 TFEU**, and the strict State aid regime under **Article 107 TFEU** indirectly shape national tax policies. The result is a system in which fiscal sovereignty is formally preserved, yet substantively conditioned by market and competition law.

Together, the TEU and TFEU construct a model of fiscal governance that is coordinated but not centralised. Surveillance mechanisms and market constraints coexist with strong national autonomy over taxation. This constitutional design, combining monetary unity with fiscal decentralisation, constitutes one of the structural foundations of Europe's persistent fiscal divergence and ultimately underpins the emergence of "two fiscal speeds" within the Union.

1.4 The Principles of Free Movement and Fair Competition

The principles of free movement and fair competition form the core of the European Union's economic architecture. They provide the legal and institutional foundations for the functioning of the Single Market and guide the interaction between national economic policies and EU level rules. These principles were conceived to eliminate internal barriers, discourage protectionist behaviour, and ensure that economic decisions within the Union are shaped by market forces rather than by discriminatory national measures. Together, they represent the EU's commitment to creating an integrated economic space where businesses, workers, and consumers can operate without unjustified restrictions.

The principle of free movement encompasses four fundamental freedoms: the free movement of goods, services, capital, and persons. These freedoms aim to remove obstacles that historically fragmented European markets and limited cross-border economic activity. By guaranteeing the unrestricted circulation of products and factors of production, the EU sought to promote efficiency, increase competitiveness, and stimulate growth. Over time, legislative harmonisation, mutual recognition, and judicial decisions have strengthened these freedoms, ensuring that national regulations do not undermine the integrity of the Single Market. The removal of internal borders has therefore facilitated the emergence of an economic environment in which firms can scale their operations beyond national boundaries and European citizens can work, study, or invest across the Union.

The principle of fair competition complements free movement by ensuring that market conditions remain open, transparent, and non-distortive. EU competition policy addresses practices such as cartels, abuses of dominant positions, and anti-competitive mergers, while state aid rules prevent governments from granting selective advantages to domestic firms. These instruments are essential for preventing national interventions that could fragment the Single Market or generate unequal competitive conditions. By limiting the ability of member states to favour domestic industries through subsidies, tax exemptions, or regulatory privileges, EU competition policy reinforces the idea that firms should compete on merit rather than based on state support.

Despite their effectiveness in promoting market integration, these principles interact in complex ways with national fiscal policies. While the EU has strong competences in regulating competition and supervising state aid, it has limited authority in taxation. This imbalance means that member states retain considerable freedom to design their own tax regimes, which can influence business decisions, investment flows, and competitive dynamics within the Single Market. As some countries have adopted low-tax strategies to attract foreign investment, tensions have emerged between the goals of free movement, fair competition, and fiscal sovereignty. These tensions are particularly evident in debates over corporate taxation, tax rulings, and the regulatory treatment of multinational enterprises.

Ultimately, the principles of free movement and fair competition were designed to support a single economic space, but they also highlight the constraints of the EU's institutional model. They ensure that national policies do not undermine market integration, yet they do not prevent significant divergence in fiscal strategies. This structural asymmetry has allowed diverse fiscal models to coexist, contributing to the broader phenomenon of Europe's "two fiscal speeds" and raising important questions about the future of integration in the absence of more comprehensive fiscal harmonisation.

1.5 The Limits of EU Competence in Taxation

The limits of the European Union's competence in taxation constitute one of the core structural constraints of fiscal integration. Under the principle of conferral enshrined in **Article 5(2) TEU**, the Union may act only within the competences attributed to it by the Treaties. Taxation, however, has never been transferred as an exclusive or shared competence in general terms; it remains primarily within Member State sovereignty. This constitutional choice reflects both the political sensitivity of taxation, closely linked to democratic legitimacy and budgetary autonomy, and the diversity of national economic and welfare systems across the Union.

The Treaties allow only limited forms of tax harmonisation. Pursuant to **Article 113 TFEU**, the Council may adopt provisions for the harmonisation of indirect taxation (notably VAT and excise duties) insofar as necessary for the functioning of the internal market. More broadly, **Article 115 TFEU** permits the approximation of laws affecting the internal market, including certain aspects of direct taxation. Crucially, both legal bases require unanimity in the Council, thereby granting each Member State veto power over fiscal reform. This unanimity rule has significantly constrained efforts toward deeper corporate tax coordination, including proposals for a common consolidated tax base or minimum effective taxation standards.

At the same time, taxation is indirectly shaped by supranational constraints derived from market and competition law. The prohibition of discriminatory taxation under **Article 110 TFEU**, the internal market objective in **Article 26 TFEU**, and the State aid regime under **Article 107 TFEU** limit certain national practices. Nevertheless, these provisions do not establish a unified fiscal authority; rather, they operate as corrective mechanisms within a fundamentally decentralised system.

The result is a model of fiscal governance characterised by coordination without centralisation. Member States retain broad discretion over corporate tax rates, fiscal incentives, and revenue structures, enabling divergent strategies ranging from high-tax redistributive systems to competitive low-tax regimes. While secondary legislation, such as anti-avoidance directives adopted under Article 115 TFEU, enhances transparency and administrative cooperation, it does not alter the constitutional allocation of powers.

Ultimately, the Treaties institutionalise a structural asymmetry: monetary integration is centralised, whereas fiscal sovereignty remains national. This constitutional design not only limits the Union's capacity to harmonise taxation but also structurally enables the persistence of divergent fiscal models, a key underlying condition for the emergence of Europe's "two fiscal speeds."

Chapter 2: Fiscal Competition within the European Union

2.1 Introduction to Fiscal Competition

Fiscal competition has become a defining feature of the European Union's economic landscape. Although the EU is founded on principles of economic integration, the coexistence of distinct national tax systems within a single market creates an environment in which member states can, intentionally or unintentionally, compete through their fiscal policies. Fiscal competition occurs when governments adjust tax rates, incentives, or regulatory frameworks in ways designed to attract investment, mobile capital, skilled labour, or multinational enterprises. While such strategies can yield benefits for individual countries, they also generate tensions within an integrated economic area, particularly when differences in fiscal regimes become sufficiently large to affect competitiveness, revenues, and the distribution of economic activity.

The roots of fiscal competition in the EU lie in the institutional architecture established by the Treaties. While monetary and trade policies have been progressively centralised, taxation has remained largely under national control. This institutional asymmetry means that member states retain the power to design tax systems tailored to their economic models, political priorities, and welfare structures. As a result, fiscal competition within the EU differs from competition between countries globally: it takes place within an integrated market characterised by free movement of goods, services, capital, and persons, where cross-border mobility magnifies the effects of national tax choices.

Fiscal competition can take several forms. Some countries use corporate tax rates as a tool to attract foreign investment and multinational enterprises, leveraging low rates and favourable tax rulings to gain a competitive advantage. Others rely on targeted incentives, such as preferential regimes for intellectual property, favourable treatment of holding companies, or sector-specific tax benefits. High-tax economies, by contrast, focus on maintaining strong welfare systems, high-quality public services, and robust institutional capacity, using broader tax bases and higher revenue levels to support their social and economic structures. These different strategies reflect contrasting economic philosophies and historical development paths, contributing to the emergence of diverse fiscal models within the EU.

The consequences of fiscal competition are complex and multidimensional. On one hand, competition can encourage efficiency, innovation, and fiscal discipline, pushing governments to improve the attractiveness of their business environments. On the other hand, uncoordinated competition may erode tax bases, increase inequality, distort investment decisions, and undermine the financial sustainability of welfare systems. The coexistence of high-tax and low-tax models within the same integrated market therefore raises important questions about fairness, economic cohesion, and the long-term stability of the Union.

Understanding fiscal competition is essential for analysing the dynamics that underpin Europe's "two fiscal speeds." As member states adopt divergent fiscal strategies, differences in revenue generation, public investment capacity, social outcomes, and economic performance inevitably emerge. These divergences shape not only national trajectories but also the broader functioning of the EU, influencing policy debates, power relations, and the prospects for deeper integration. For these reasons, fiscal competition represents both an economic phenomenon and a central analytical lens for understanding the structural transformations occurring within the European Union.

2.2 Theoretical Framework

The study of fiscal competition within the European Union draws on a broad theoretical literature that examines how governments design tax policies in a context characterised by mobility of capital, integration of markets, and institutional asymmetries. Several theoretical perspectives contribute to understanding the incentives, constraints, and outcomes associated with fiscal competition, each offering insights into why member states adopt different fiscal strategies and how these strategies interact within an integrated economic system.

One of the foundational theories is the concept of tax competition, which posits that governments reduce tax rates or introduce preferential regimes to attract mobile economic resources. According to this perspective, greater economic openness increases the sensitivity of capital and high-skilled labour to tax differentials, leading countries to adjust their policies to remain competitive. This dynamic can create downward pressure on corporate taxation, a phenomenon often described as a "race to the bottom." In the EU, where capital mobility is high and monetary policy is centralised, national governments may feel even stronger incentives to use taxation as a tool to influence investment flows and economic activity.

Another relevant theoretical approach is the theory of fiscal federalism, which explores how responsibilities should be allocated between central and subnational authorities in a multi-level governance system. Although the EU is not a federal state, the principles of fiscal federalism help explain the challenges of coordinating fiscal policy across member states. A key insight from this literature is that decentralised fiscal authority can promote flexibility and allow governments to tailor policies to local preferences, but it can also lead to inefficiencies, spillovers, and coordination problems when economic activities cross borders. These issues become particularly salient in the EU, where member states operate within a single market but maintain control over taxation.

Institutionalist theories also play an important role in interpreting fiscal competition. These approaches emphasise how historical trajectories, administrative structures, and political cultures shape national tax systems and influence the capacity of governments to adapt to external pressures. From this perspective, fiscal competition is not solely the result of market forces but is filtered through domestic institutions that determine how countries perceive and respond to competitive threats. High-tax coordinated economies and low-tax competitive models therefore emerge from distinct institutional environments rather than from uniform responses to globalisation.

Public choice theory provides an additional lens for analysing fiscal behaviour. It suggests that political incentives, electoral dynamics, and interest group pressures influence how governments design tax policies. For example, policymakers may adopt competitive tax regimes to signal economic openness, attract investment, or appeal to specific constituencies. Conversely, governments prioritising social welfare and redistribution may maintain higher tax levels to support public services. These political factors interact with economic and institutional constraints, producing diverse fiscal strategies across member states.

Finally, theories of European integration contribute to understanding the broader context in which fiscal competition takes place. The EU's asymmetric structure, characterised by centralised monetary policy and decentralised fiscal authority, creates conditions in which national tax decisions have significant cross-border effects. Integration theories highlight the tension between economic interdependence and sovereignty, explaining why deeper fiscal harmonisation remains difficult despite the growing need for coordinated action.

Together, these theoretical perspectives form a comprehensive framework for analysing fiscal competition in the EU. They illuminate the economic incentives, institutional foundations, political motivations, and governance challenges that underpin divergent fiscal models. Understanding this theoretical landscape is essential for interpreting how and why Europe has developed "two fiscal speeds" and for assessing the implications for future integration and policy coordination.

2.3 Forms and Instruments of Fiscal Competition in the EU

Fiscal competition within the European Union operates through a range of instruments that Member States deploy to attract mobile capital, high-value activities, and skilled labour within the framework of the internal market. While taxation remains largely within national competence, its exercise is structurally conditioned by the Treaties, particularly by the internal market objective enshrined in **Article 26 TFEU** and the principle of non-discrimination under **Article 110 TFEU**. Within these boundaries, governments retain significant discretion to design competitive tax regimes.

The most common instruments of fiscal competition include reduced corporate income tax rates, preferential intellectual property (IP) regimes, targeted tax credits for research and development, advance tax rulings, special economic zones, and favourable expatriate taxation schemes. These tools serve different strategic purposes: some directly lower the effective tax burden on multinational enterprises, while others incentivise innovation, capital relocation, or human capital mobility.

However, fiscal competition does not operate in a legal vacuum. Certain practices may fall under the scrutiny of EU competition law, particularly the State aid regime established in **Article 107 TFEU**, which prohibits selective advantages that distort competition within the internal market. High-profile investigations into preferential tax rulings have demonstrated that, although Member States retain fiscal sovereignty, their policies remain subject to supranational oversight when they confer selective economic advantages. Moreover, **Article 116 TFEU** provides a legal basis to address distortions of competition resulting from divergent national laws, although it has rarely been used in the field of direct taxation.

Table 2.3 — Comparative Overview of Tax Competition Instruments in Selected EU Member States

Instrument	Description	Purpose	Countries Associated
Low Corporate Tax Rates	Statutory corporate income tax significantly below EU average.	Attract mobile capital and multinational enterprises.	Ireland, Hungary, Cyprus, Bulgaria
Preferential IP Regimes	Reduced taxation on income from patents, trademarks, and intangible assets.	Support innovation and attract R&D-intensive; firms.	Netherlands, Luxembourg, Belgium
Tax Rulings / APAs	Advance agreements clarifying tax treatment of complex transactions.	Provide legal certainty; lower effective tax burden.	Netherlands, Luxembourg, Belgium
Holding Company Regimes	Favourable taxation of dividends, capital gains, and intra-group flows.	Attract headquarters and financial structures of multinationals.	Netherlands, Luxembourg, Belgium
R&D; Incentives	Deductions or credits for research activities and innovation spending.	Stimulate domestic innovation and high-tech investment.	Germany, France, Italy, Spain
Expat Schemes (Labour)	Preferential tax treatment for foreign / high-skilled workers.	Attract talent and strengthen labour market.	Netherlands, Denmark, Portugal
Expat Schemes / Labour Tax Incentives	Local tax exemptions combined with simplified regulatory procedures.	Promote regional development and foreign investment.	Netherlands, Denmark, Portugal
Special Economic Zones (SEZs)	Local tax exemptions with simplified regulatory procedures.	Promote regional development and foreign direct investment.	Poland, Lithuania, Croatia
Notional Interest Deduction	Deduction based on hypothetical return on equity.	Reduce tax bias between debt and equity financing.	Belgium (historically), Italy (until recent reforms)

Source*: Author's elaboration based on European Commission (DG TAXUD), OECD Corporate Tax Statistics, OECD BEPS Reports, and national tax legislation (2023–2024).*

Taken together, these instruments illustrate a structural tension embedded in the Treaties: Member States are encouraged to compete within the internal market, yet excessive fiscal differentiation may undermine the very level playing field the Union seeks to protect.

The coexistence of competitive low-tax strategies and high-tax redistributive models reflects the decentralised nature of fiscal authority within the EU. This dynamic not only shapes investment patterns and corporate location choices but also contributes to the consolidation of Europe's "two fiscal speeds," rooted in the constitutional balance between national fiscal autonomy and supranational market integration.

2.4 Case Studies of Fiscal Models

The coexistence of diverse fiscal strategies within the European Union can be understood more clearly through the examination of specific national models. Case studies provide insight into how different historical trajectories, institutional structures, and policy choices shape the fiscal environments of member states. They reveal not only the motivations behind certain strategies but also the consequences these choices generate within an integrated market. This section presents a concise analysis of two contrasting approaches: the high-tax coordinated model typical of countries like Germany, and the competitive-tax model exemplified by Ireland. Together, these cases illustrate the structural forces driving Europe's fiscal divergence.

Germany represents a high-tax coordinated model, characterised by an extensive welfare state, a broad tax base, and a stable regulatory environment. Its fiscal strategy relies on relatively high levels of taxation to finance social protection, public services, and long-term investments in education, infrastructure, and technological innovation. The German model emphasises predictability, administrative efficiency, and compliance with rules-based governance, particularly within the framework of the Stability and Growth Pact. While high tax rates may reduce short-term attractiveness for highly mobile capital, Germany compensates through institutional strength, skilled labour, and high levels of productivity. This coordinated model reflects a long-standing commitment to balancing competitiveness with social cohesion.

Ireland, by contrast, follows a competitive-tax model that leverages fiscal policy to attract foreign direct investment and integrate into global value chains. Its corporate tax rate—one of the lowest in the EU—has been a central pillar of its economic strategy for decades. Complemented by targeted incentives such as intellectual property regimes and favourable tax rulings, Ireland has positioned itself as a hub for multinational enterprises, particularly in technology, pharmaceuticals, and financial services. This approach has produced impressive economic growth, high levels of investment, and strong export performance. However, it has also generated concerns about dependency on multinational firms, the volatility of tax revenues, and the impact of profit-shifting practices on other member states.

The comparison between these two models highlights the diversity of fiscal strategies within the EU. While Germany prioritises social stability, long-term competitiveness, and regulatory quality, Ireland focuses on agility, foreign investment attraction, and integration into global corporate networks. Both strategies have yielded economic success in different ways, but their coexistence within a shared economic space creates tensions and raises questions about fairness, sustainability, and policy coordination.

These case studies also show how fiscal choices interact with broader institutional frameworks. High-tax coordinated models are generally associated with strong welfare states, robust administrative capacity, and a preference for harmonisation. Competitive-tax models, by contrast, reflect a belief in market-driven growth, regulatory flexibility, and national autonomy in economic strategy. As more member states adopt different elements from these approaches, the divergence in fiscal outcomes becomes more pronounced, contributing to the emergence of Europe's "two fiscal speeds."

Overall, these examples demonstrate that fiscal competition is not merely a theoretical phenomenon, but a practical reality shaped by national priorities and institutional legacies. Understanding these models is essential for assessing the broader implications of fiscal divergence and for analysing how differing strategies influence the direction and coherence of European integration.

2.5 Economic and Social Implications

Fiscal competition within the European Union generates a series of economic and social implications that extend far beyond differences in tax policy. While competitive strategies can stimulate investment and innovation, the resulting asymmetries in fiscal capacity, welfare provision, and economic resilience contribute to increasingly visible divergences among member states. These dynamics affect not only national economies but also the cohesion and long-term stability of the EU.

From an economic perspective, fiscal competition influences the distribution of investment and productive activity across the Union. Countries with low corporate tax rates and favourable regimes for multinational enterprises often attract significant inflows of foreign direct investment, particularly in high-tech and export-oriented sectors. This can boost growth, enhance productivity, and generate employment opportunities. However, such benefits are not equally accessible to all member states. High-tax coordinated economies, especially those with rigid labour markets or less flexible regulatory environments, may find it more difficult to compete for mobile capital, even when they possess strong structural advantages such as skilled labour or advanced infrastructure. As investment becomes concentrated in a subset of countries, disparities in economic performance deepen, reinforcing the pattern of "two fiscal speeds."

Another important economic consequence concerns national revenue systems. Competitive tax regimes frequently rely on narrow tax bases or volatile revenue streams linked to multinational activity, creating vulnerability during periods of economic downturn or profit relocation. Conversely, high-tax countries often maintain more stable revenue bases but face pressure to adjust their tax systems to prevent capital flight or maintain competitiveness. These conflicting dynamics can undermine fiscal sustainability, complicate budget planning, and influence governments' ability to fund long-term investment or respond effectively to economic shocks.

The social implications of fiscal competition are equally significant. Divergent tax strategies shape welfare regimes, income distribution, and labour market conditions. High-tax countries typically support extensive social protection systems that mitigate inequality and provide broad access to healthcare, education, and public services. These systems contribute to social cohesion and long-term human capital development but require substantial fiscal resources. Low-tax competitive models, by contrast, tend to prioritise market-driven growth and maintain more limited welfare structures. While these models may achieve rapid economic expansion, they also risk generating social disparities, housing pressures, and vulnerabilities for groups less integrated into high-growth sectors.

Labour mobility within the EU further amplifies these effects. Workers, particularly those with high skills, are more likely to move toward countries offering favourable tax treatment, strong employment opportunities, or dynamic sectors. This mobility can benefit host economies but may exacerbate demographic challenges in sending countries, especially in regions already facing ageing populations or skill shortages. These patterns contribute to uneven social development and influence political dynamics, including perceptions of fairness and solidarity within the Union.

Ultimately, the economic and social implications of fiscal competition highlight the complex interplay between national autonomy and European integration. While fiscal diversity allows member states to tailor their policies to national preferences, it also creates structural imbalances that affect the functioning of the Single Market and the credibility of the EU's commitment to cohesion. As divergences deepen, they raise important questions about the long-term sustainability of a common economic project in which tax strategies and welfare capacities evolve along increasingly different paths.

2.6 Policy Responses and Coordination Attempts

The expansion of fiscal competition within the European Union has triggered a progressive strengthening of coordination mechanisms at supranational level. While taxation remains primarily a national competence, the Treaties provide legal bases for economic policy coordination rather than fiscal harmonisation. In particular, **Article 121 TFEU** establishes the framework for multilateral surveillance of economic policies, forming the legal foundation of the European Semester. Through this mechanism, the Union monitors budgetary plans, macroeconomic imbalances, and structural reforms, aiming to ensure policy consistency within the internal market.

Complementing this framework, **Article 126 TFEU** introduces the Excessive Deficit Procedure (EDP), which seeks to safeguard fiscal discipline by setting reference values for public deficits and debt levels. Although these provisions enhance surveillance and peer pressure, they do not transfer taxation powers to the Union. Instead, they operate within a system where Member States retain sovereignty over revenue structures and tax rates.

Further differentiation is visible in **Article 136 TFEU**, which allows the adoption of specific measures applicable only to euro area Member States. This provision has facilitated deeper coordination within the monetary union, reinforcing fiscal discipline among euro countries while leaving non-euro members outside certain integration steps. The adoption of the Fiscal Compact, although intergovernmental and formally outside the EU legal order, strengthened this trajectory by embedding stricter budgetary rules into national constitutional frameworks.

Beyond fiscal surveillance, the Union has sought to address distortive tax practices through secondary legislation adopted under **Article 115 TFEU**, notably anti-avoidance directives and enhanced administrative cooperation. These instruments establish minimum standards and improve transparency but stop short of harmonising corporate tax systems. The persistence of the unanimity requirement in tax matters continues to limit transformative reform.

Recent innovations, such as joint borrowing under the Recovery and Resilience Facility, demonstrate the Union's capacity for pragmatic integration in times of crisis. Yet even these steps do not fundamentally alter the allocation of competences defined in the Treaties. The overall governance model remains characterised by coordination without centralisation: fiscal rules are supervised at EU level, but taxation itself remains largely national.

This structural distinction is crucial. The Union coordinates budgetary behaviour and constrains macroeconomic instability, yet it lacks the authority to harmonise core elements of fiscal sovereignty. As a result, policy responses mitigate the excesses of fiscal competition but do not eliminate the underlying divergence, thereby reinforcing the broader dynamics that sustain Europe's "two fiscal speeds."

Chapter 3: The Two Fiscal Speeds of Europe

3.1 Introduction: Understanding "Two Fiscal Speeds"

The concept of "two fiscal speeds" has become an influential framework for interpreting the structural divergences that characterise the European Union. Although the EU is founded on the principles of economic integration and convergence, member states have developed increasingly distinct fiscal strategies, institutional capacities, and economic trajectories. These differences have deepened since the financial and sovereign debt crises, revealing the limitations of a system in which monetary policy is centralised while fiscal policy remains largely national. The resulting landscape is one in which countries move at different fiscal and economic "speeds," shaping the dynamics of integration and influencing the functioning of the Single Market and the Economic and Monetary Union.

At the core of this concept is the recognition that the EU includes two broad, though not rigid, fiscal models. On one side are high-tax coordinated economies, such as Germany and other Northern European countries, which rely on extensive welfare systems, strong institutional frameworks, and broad-based taxation to support social cohesion, long-term investment, and regulatory stability. On the other side are competitive-tax economies, exemplified by Ireland and the Netherlands, which use low corporate tax rates, targeted incentives, and flexible regulatory frameworks to attract foreign investment and integrate into global value chains. These models reflect different economic philosophies, political traditions, and institutional arrangements, leading to divergent outcomes in terms of growth, productivity, revenue capacity, and social development.

The divergence accelerated in the aftermath of the eurozone crisis. Countries with strong fiscal positions and high institutional capacity were able to recover more quickly, benefiting from favourable borrowing conditions and stable public finances. By contrast, member states with higher debt levels, weaker administrative structures, or more constrained fiscal space experienced prolonged adjustment periods, slower growth, and persistent social challenges. These disparities underscore how structural differences in fiscal systems shape the resilience of national economies within a shared monetary framework.

At the same time, fiscal competition within the Single Market has amplified the divide. Competitive-tax countries have attracted disproportionate shares of foreign direct investment and multinational activity, reinforcing their growth models and expanding their tax bases. High-tax economies have faced pressure to adapt their fiscal regimes to maintain competitiveness, even as they continue to prioritise social objectives. The coexistence of these strategies within an integrated economic area generates tensions related to fairness, regulatory coherence, and the distribution of economic opportunities.

Understanding the emergence of "two fiscal speeds" also requires recognising the political dimension of fiscal divergence. National governments hold different preferences regarding fiscal harmonisation, tax sovereignty, and the role of the EU in economic governance. These differing visions influence negotiations on fiscal reforms, state aid rules, and budgetary policies, shaping the trajectory of European integration. The persistence of divergent models therefore reflects not only economic structures, but also political choices and institutional constraints embedded within the EU's governance system.

This chapter explores the origins, manifestations, and implications of these divergent fiscal paths. It examines the historical factors that contributed to the emergence of the two models, analyses economic indicators that reveal long-standing differences, and evaluates how fiscal divergence affects social outcomes, institutional dynamics, and the political economy of the Union. By outlining the key characteristics of Europe's two fiscal speeds, the chapter provides a foundation for the comparative analysis developed in Chapter 4 and the regulatory assessment presented in Chapter 5.

3.1.1 Concept and Origins of Fiscal Divergence

Fiscal divergence refers to the gradual development of structurally different fiscal models among EU member states, despite their participation in a common economic and institutional framework. Rather than converging, countries have maintained and strengthened distinct approaches to taxation, enforcement capacity, and the balance between competitiveness and redistribution.

A key origin lies in the EU's institutional design. European integration progressed through market and monetary integration, while taxation and public spending remained politically sensitive and therefore mostly national. This created an incomplete architecture: a highly integrated market where firms can operate across borders, but where **tax bases, enforcement, and corporate taxation rules differ significantly**.

Over time, globalisation and the rise of highly mobile capital strengthened incentives for some countries to compete through tax policy. Low corporate tax rates, preferential regimes (e.g., for IP), and advance rulings became tools for attracting multinational structures and reported profits. In practice, this has contributed to a persistent gap between countries with strong domestic tax bases and those whose growth models depend more heavily on tax attractiveness and multinational activity.

3.1.2 Fiscal Competition within the Single Market

Fiscal competition is one of the mechanisms that makes "two fiscal speeds" particularly visible. Within the Single Market, companies can organise production, headquarters, and intellectual property across jurisdictions. When tax systems differ, this mobility creates strong incentives to locate profits, assets, or key functions where tax treatment is most favourable.

Competitive-tax economies have been able to attract disproportionate shares of multinational activity and, in some cases, generate high corporate tax revenues even with low statutory rates. At the same time, this dynamic can place pressure on other member states, especially those with higher tax rates and larger welfare commitments, which face concerns about base erosion and the perceived unfairness of the playing field.

In this context, divergence is not only about different "preferences," but also about different **fiscal capacities and bargaining positions**. Countries that rely on competitive tax regimes tend to resist reforms that would reduce national advantage, while countries experiencing stronger pressure on their tax base tend to support coordination and harmonisation.

3.1.3 Fiscal Integration and Its Discontents

Fiscal integration remains contested because it touches national sovereignty and different growth models. Harmonisation can be seen as necessary to protect the integrity of the Single Market, but it can also be perceived as a direct constraint on national strategies.

High-tax coordinated economies often support stronger coordination to limit aggressive tax competition and protect revenue bases. Competitive-tax economies tend to oppose measures that would reduce flexibility in corporate taxation or limit the use of targeted regimes. As a result, EU fiscal governance has developed through partial tools (surveillance, soft coordination, selective reforms), rather than through a fully centralised fiscal authority.

This tension helps explain why the EU can produce common rules in some areas, but struggles to move toward a stable and comprehensive framework in corporate tax policy and enforcement.

3.2 Economic Divergences Among Member States

Economic divergences among EU member states are visible in macroeconomic indicators such as GDP growth, productivity, and public debt. These differences shape fiscal capacity, competitiveness, and the resilience of national economies. The table below summarises broad patterns that distinguish high-performing Northern economies from structurally weaker Southern and peripheral ones.

Table 3.2 — Comparative Structural Indicators of Economic Divergence in the European Union

(Indicative comparative patterns, not numerical values)

Indicator	High-Performing / Northern Economies (e.g. Germany, Netherlands, Denmark)	Structurally Weaker / Southern Economies (e.g. Italy, Spain, Greece)
GDP Growth (Trend)	More stable and sustained; driven by exports, innovation, industrial strength.	More volatile; slower long-term growth; vulnerable to shocks and external demand.
Productivity Levels	High productivity; strong manufacturing, digitalisation, and R&D.;	Lower productivity; structural rigidities; limited innovation capacity.
Public Debt	Generally lower and stable; strong market credibility.	Higher debt burdens; greater exposure to interest rate fluctuations and market pressure.
Investment Capacity	High public and private investment; strong infrastructure and R&D; spending.	Constrained by fiscal limits; underinvestment in infrastructure and innovation.
Labour Market Performance	Lower unemployment; strong vocational systems; higher wages.	Higher unemployment; dual labour markets; lower wage growth.
Fiscal Space	Greater ability to conduct countercyclical policy; stable revenues.	Limited fiscal space; reliance on austerity in downturns; structural deficits.
Institutional Strength	Efficient administration; strong governance; stable regulatory environment.	Institutional constraints; administrative inefficiencies; slower policy implementation.

Source*: Author's elaboration based on Eurostat (National Accounts and Government Finance Statistics), OECD Productivity Statistics, World Bank Governance Indicators, and European Commission Country Reports (2023–2024).*

The patterns in Table 3.2 highlight that economic divergence across the EU is not only cyclical, but also structural. Long-term differences in productivity, investment, institutional quality, and fiscal space create unequal starting conditions across member states and shape national policy choices within the shared EU framework.

Overall, Northern economies tend to combine stronger growth drivers, higher productivity, and more stable public finances. In contrast, many Southern and weaker economies face persistent constraints, including lower productivity growth, higher debt, and more fragile labour markets, which reduce their ability to invest and make convergence more difficult.

Differences in fiscal capacity reinforce these dynamics. Countries with stable public finances can respond to downturns more effectively and support long-term investment, while countries with limited fiscal space are more exposed to shocks and often face tighter trade-offs between adjustment and growth.

3.2.1 Differences in GDP Growth, Productivity, and Debt

Differences in GDP growth, productivity, and public debt are among the clearest indicators of divergence in the EU, as they directly shape fiscal capacity and policy autonomy. Over time, these trends have contributed to distinct economic "paths" within the Union.

GDP growth has been more stable in many Northern and Central European countries, supported by export capacity and sustained investment in innovation. In several Southern and peripheral economies, growth has been weaker and more volatile, and major shocks, particularly the eurozone crisis and the pandemic, have amplified pre-existing structural gaps.

Productivity plays a central role in this divergence. High-productivity economies benefit from stronger innovation ecosystems, advanced manufacturing structures, and higher levels of digitalisation. By contrast, productivity growth has remained comparatively subdued in parts of Southern Europe, often linked to structural rigidities and lower investment in research, development, and technological upgrading.

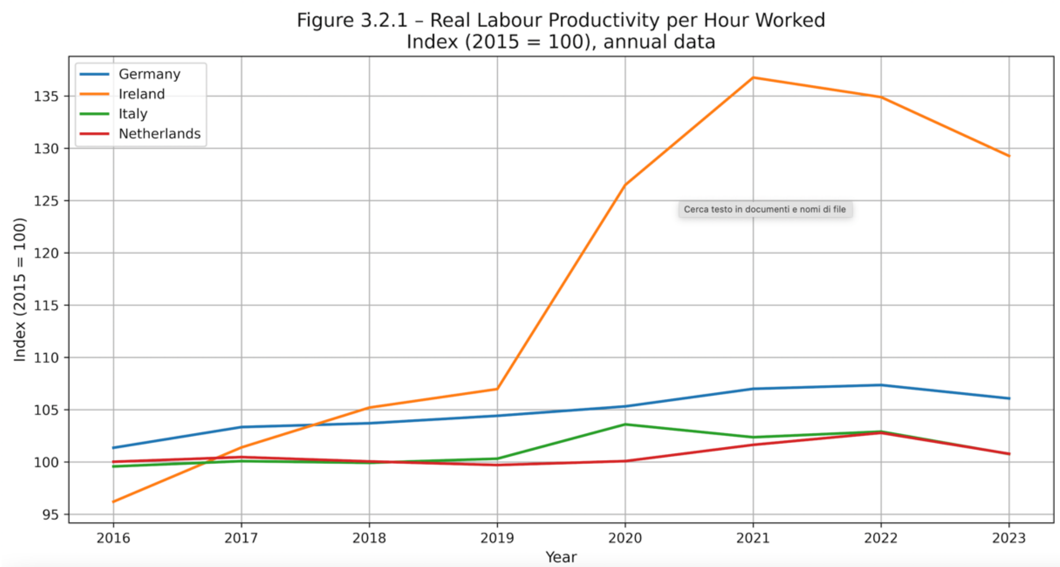
Public debt further reinforces this divide. Countries with lower debt ratios typically retain greater room for countercyclical policy and public investment. Highly indebted economies operate under tighter fiscal constraints, greater exposure to financial market conditions, and stronger dependence on EU fiscal surveillance mechanisms, which can narrow long-term policy options.

Figure 3.2.1 — Real Labour Productivity per Hour Worked in Selected EU Member States (Index 2015 = 100), 2016–2023

Dataset: **Labour productivity and unit labour costs [nama_10_lp_ulc__custom_20122800]**
Last updated: 13/02/2026 23:00

Time frequency Annual
Unit of measure Index, 2015=100
National accounts indicator (E Real labour productivity per hour worked

TIME	2016	2017	2018	2019	2020	2021	2022		2023	
GEO (Labels)										
Germany	101,354	103,333	103,697	104,412	105,310	106,992	107,352	p	106,074	p
Ireland	96,198	101,385	105,196	106,967	126,488	136,762	134,887		129,263	
Italy	99,569	100,075	99,916	100,309	103,592	102,361	102,897		100,756	
Netherlands	100,014	100,461	100,046	99,702	100,077	101,635	102,778		100,780	p



Source: *OECD Data Explorer,* Labour productivity and unit labour costs (nama_10_lp_ulc)*, indicator: Real labour productivity per hour worked (Index 2015=100), annual data, extracted February 2026. Author's elaboration.*

These macroeconomic asymmetries do not remain confined to economic outcomes. They translate into differentiated fiscal behaviours and institutional preferences within the Union. Divergent levels of growth, productivity, and debt shape how Member States interpret fiscal sustainability, budgetary discipline, and regulatory flexibility, thereby influencing their stance toward EU fiscal governance.

3.2.2 Diverging Fiscal Cultures and Policy Approaches

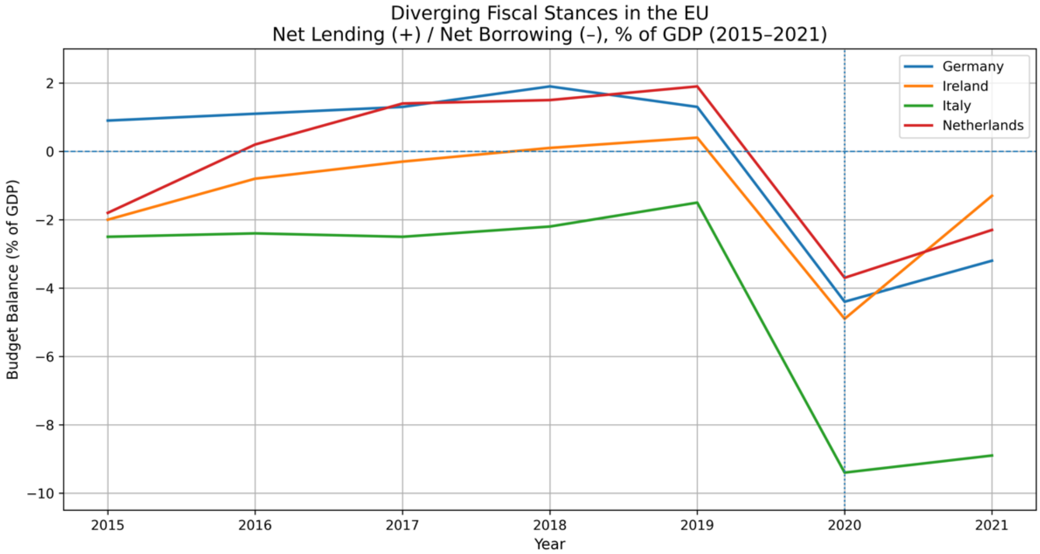
Diverging fiscal cultures provide a structural explanation for the differentiated trajectories observed across Member States. Fiscal balances do not merely reflect cyclical conditions; they embody institutional capacity, political preferences, and distinct interpretations of fiscal sustainability within the EU framework.

Figure 3.2.2 – General Government Budget Balance (% of GDP): Comparative Fiscal Trajectories (2015–2021)

Dataset: **Government deficit/surplus, debt and associated data [gov 10dd edpt1$defaultview]**
Last updated: 21/10/2025 11:00

Time frequency Annual
Unit of measure Percentage of gross domestic product (GDP)
Sector General government
National accounts indicator (E Net lending (+)/net borrowing (-)

TIME	2015	2016	2017	2018	2019	2020	2021
GEO (Labels)							
Germany	0,9	1,1	1,3	1,9	1,3	-4,4	-3,2
Ireland	-2,0	-0,8	-0,3	0,1	0,4	-4,9	-1,3
Italy	-2,5	-2,4	-2,5	-2,2	-1,5	-9,4	-8,9
Netherlands	-1,8	0,2	1,4	1,5	1,9	-3,7	-2,3



Source: Eurostat (2025), Net lending (+) / Net borrowing (–) of general government (% of GDP), annual data. Author's elaboration.

As shown in Figure 3.2.2, the period 2015–2019 reveals a clear contrast. Germany and the Netherlands recorded persistent surpluses prior to the pandemic, consistent with a rules-based fiscal orientation and strong administrative capacity. Ireland followed a gradual consolidation path within a competitive-tax model. Italy, by contrast, maintained structurally negative balances, reflecting tighter fiscal space and higher legacy debt constraints. These differences indicate not only economic divergence, but distinct governance traditions in budgetary management.

The 2020 shock generated an extraordinary fiscal expansion across all countries. However, the magnitude and recovery dynamics underline pre-existing asymmetries: surplus countries entered the crisis with greater countercyclical capacity, while higher-debt economies experienced sharper fiscal deterioration. The differentiated adjustment in 2021 confirms that fiscal space remains unevenly distributed within the Union.

These patterns shape Member States' preferences in EU fiscal governance. Countries with stronger fiscal positions tend to emphasise rule enforcement and debt sustainability, whereas more constrained economies prioritise flexibility to preserve investment and social expenditure. Fiscal culture therefore operates as a mediating variable between economic structure and regulatory integration, reinforcing the emergence of "two fiscal speeds" within the European Union.

3.3 Fiscal and Social Consequences of Divergence

The growing divergence among EU member states has important fiscal and social consequences that go beyond economic performance. As countries follow different fiscal paths, inequalities in welfare provision, labour markets, and fiscal capacity become more visible, reinforcing the pattern of Europe's two fiscal speeds.

From a fiscal perspective, differences in revenue capacity are central. High-tax coordinated economies benefit from broad tax bases and stable public finances, which allow them to sustain welfare systems, invest in innovation, and respond more effectively to economic shocks. In contrast, countries with more limited fiscal capacity face structural constraints that reduce their ability to finance public services or long-term investment. This often creates a self-reinforcing cycle in which weak fiscal capacity limits growth, further constraining public finances.

Social outcomes also differ across the Union. Countries with strong redistributive systems tend to achieve lower levels of inequality and stronger social protection. Competitive-tax economies, while often dynamic and attractive to investment, may display higher income dispersion and more segmented labour markets. These differences shape access to opportunities and living standards across member states.

Labour mobility interacts with these dynamics. While the free movement of workers improves labour allocation at the EU level, it often reinforces divergence. Skilled workers tend to move toward more prosperous economies, strengthening receiving countries but reducing human capital and tax bases in sending ones. Over time, this contributes to persistent development gaps.

Finally, divergent fiscal and social outcomes influence EU governance. Member states experiencing different economic realities hold conflicting priorities regarding fiscal rules, redistribution, and the role of the EU, making coordinated policy responses more difficult.

Table 3.3 — Structural Economic Divergence Patterns in Selected EU Member States

(*Comparative synthesis based on OECD, Eurostat and European Commission data)*

Dimension	High-Tax Coordinated Economies (e.g., Germany, Denmark, Sweden)	Structurally Weaker (e.g., Italy, Spain, Greece)
Welfare Systems	Extensive, universal, high-quality welfare; strong redistributive capacity.	More volatile; slower long-term growth; vulnerable to shocks and external demand.
Income Inequality	Generally low thanks to progressive taxation and redistribution.	Mixed: low-to-medium inequality but higher reliance on market-driven income patterns.
Labour Market Outcomes	High employment; strong vocational training; low long-term unemployment.	Higher structural unemployment; more fragile labour market structures.
Competitiveness Model	Based on innovation, productivity, skilled workforce, industrial base.	Based on tax attractiveness, FDI inflows, multinationals, high-tech sectors.
Fiscal Capacity	Strong, stable revenues; countercyclical capacity.	High but more volatile corporate tax revenues; narrower base.
Social Stability & Cohesion	High: strong safety nets reduce poverty and inequality.	Limited fiscal space; greater vulnerability to shocks.
Human Capital Formation	High public investment in education, R&D;, lifelong learning.	Strong in specific sectors; driven by multinationals.

Source*: Author's elaboration based on Eurostat (National Accounts, Government Finance Statistics), OECD (Productivity and Economic Outlook), and European Commission Country Reports (2023–2024).*

3.3.1 Effects on Welfare, Inequality, and Competitiveness

Fiscal divergence affects welfare systems, inequality, and competitiveness in different ways across the EU. High-tax coordinated economies use their fiscal capacity to support inclusive welfare systems and long-term investment, which helps reduce poverty and strengthen human capital. Competitive-tax economies, while attractive to investment, often rely on narrower tax bases and provide more limited social protection, which can increase exposure to market risks and widen social gaps.

Inequality is generally lower in countries with strong redistributive systems, while more market-driven models tend to show wider income dispersion, especially where growth is concentrated in specific sectors. At the same time, competitiveness follows different paths: high-tax models rely on productivity and innovation, whereas competitive-tax models focus on attracting mobile capital and multinational firms. This coexistence creates tension between social inclusion and tax-based competitiveness within the Single Market.

3.3.2 Structural Imbalances and Labour Mobility

Structural imbalances and labour mobility are key channels through which divergence persists. Countries with strong industrial bases and innovation capacity attract more investment and skilled workers, reinforcing their competitive position. Economies with weaker structures face greater difficulties in upgrading productivity and diversifying growth.

Labour mobility can improve efficiency at the EU level, but it also deepens asymmetries. Receiving countries benefit from skilled workers, while sending countries risk long-term “brain drain,” reduced tax bases, and slower development. Over time, these dynamics reinforce Europe’s two fiscal speeds and make convergence more difficult.

3.4 Political and Institutional Implications

Fiscal divergence within the European Union generates significant political and institutional consequences. As Member States pursue distinct fiscal strategies, their economic capacities, preferences, and bargaining power increasingly diverge, complicating consensus-building at Union level. This fragmentation does not merely reflect economic differences; it is structurally embedded in the constitutional framework of the Treaties.

A first implication concerns differentiated integration. Under **Article 20 TEU**, a group of Member States may establish enhanced cooperation in areas where unanimity among all members cannot be achieved. While originally conceived as a flexibility mechanism, this provision implicitly acknowledges the possibility of multiple integration speeds. In fiscal matters, where unanimity is required, enhanced cooperation becomes a potential, though politically sensitive, pathway for deeper alignment among willing states.

Differentiation is even more visible within the euro area. **Article 136 TFEU** allows the adoption of specific measures applicable only to Member States whose currency is the euro. This legal basis has facilitated stronger fiscal surveillance and coordination within the monetary union, reinforcing obligations for euro countries while leaving others outside certain commitments. As a result, fiscal governance operates at varying degrees of intensity across the Union, institutionalising asymmetry.

The distribution of financial responsibilities further reflects structural divergence. According to **Article 311 TFEU**, the Union is financed through “own resources,” yet the EU budget remains limited in scale and largely dependent on national contributions. The absence of a fully-fledged central fiscal capacity constrains redistributive mechanisms at supranational level, amplifying the consequences of national fiscal disparities.

These institutional features shape power dynamics within EU decision-making. Economically stronger Member States, characterised by stable public finances and robust administrative capacity, tend to exercise greater influence over fiscal rules and reform agendas. Conversely, fiscally constrained economies often advocate for flexibility and investment support from a structurally weaker bargaining position. Diverging fiscal cultures, between high-tax coordinated systems and competitive-tax models, further intensify tensions in debates over harmonisation, state aid enforcement, and fiscal solidarity.

Ultimately, the Treaties do not mandate fiscal convergence; rather, they provide mechanisms that allow differentiated integration and preserve national sovereignty in taxation. The persistence of unanimity requirements, limited central budgetary capacity, and euro area differentiation collectively enable the coexistence of distinct fiscal trajectories. In this sense, Europe's "two fiscal speeds" are not merely a temporary outcome of policy choices, but a phenomenon structurally accommodated, and partially legitimised, by the Union's constitutional design.

3.4.1 Power Asymmetries within EU Decision-Making

Power asymmetries within the EU stem largely from differences in economic strength, fiscal stability, and institutional capacity. Larger and more competitive economies have greater leverage in shaping fiscal governance, crisis-management tools, and regulatory frameworks.

During crises, this imbalance becomes more visible. Countries facing financial stress or external surveillance often accept reforms designed by stronger member states, as seen during the eurozone crisis. Economic vulnerability reduces bargaining power and policy autonomy.

Institutional structures reinforce these dynamics. Although unanimity gives all states formal veto rights, agenda-setting and informal influence are concentrated among economically dominant members. Strong technocratic capacity also allows some states to shape technical rules and fiscal surveillance mechanisms more effectively.

As a result, decision-making power is unevenly distributed, reinforcing Europe's two fiscal speeds and complicating efforts to promote convergence.

3.4.2 National Interests and Resistance to Harmonization

Resistance to fiscal harmonisation reflects deeply rooted national interests. While harmonisation could reduce distortions and unfair competition, it also threatens fiscal sovereignty and national growth strategies.

High-tax coordinated economies tend to support harmonisation to protect their revenue bases and welfare systems. Competitive-tax economies, however, view harmonisation as a direct threat to their attractiveness for investment, which is often based on low corporate taxes and favourable regimes for multinationals.

Structurally weaker economies occupy an intermediate position: they may benefit from coordination, but fear rigid rules that limit their ability to support growth and manage shocks.

Because taxation requires unanimity, even a small group of countries can block reform. This institutional constraint preserves the status quo and allows divergent fiscal models to persist.

Ultimately, national interests and political resistance limit the scope for deeper fiscal integration, reinforcing the structural divide that characterises Europe's two fiscal speeds.

3.5 Toward Fiscal Convergence? Opportunities and Limits

The growing divergence among EU member states has revived the debate on whether greater fiscal convergence is both necessary and feasible. While deeper coordination could reduce distortions and strengthen the Economic and Monetary Union, progress remains slow and politically contested.

On the opportunity side, recent crises have shown that closer fiscal coordination is possible when collective action becomes unavoidable. The Recovery and Resilience Facility, financed through joint EU borrowing, marked an important step toward shared fiscal instruments and coordinated investment strategies. In addition, common priorities such as the green and digital transitions have increased incentives for coordinated action beyond national borders.

There is also wider recognition that persistent asymmetries in growth, productivity, and fiscal capacity threaten the long-term stability of the euro area. Without some degree of alignment, weaker economies remain structurally constrained, while stronger ones continue to benefit disproportionately from the current framework. In this context, improved coordination of tax policies, stronger enforcement, and targeted investment support are often seen as necessary to reduce the gap between Europe's two fiscal speeds.

However, major limits remain. National fiscal cultures and economic strategies differ widely. High-tax coordinated economies tend to support convergence when it protects revenue bases, while competitive-tax economies resist reforms that reduce their ability to attract investment through taxation. These conflicting interests create strong political barriers to harmonisation.

Institutional constraints further restrict progress. Taxation remains a national competence requiring unanimity, which allows even a small group of countries to block reform. As a result, fiscal governance continues to rely mainly on surveillance and soft coordination rather than binding rules.

Finally, different economic starting points complicate convergence. Highly indebted or institutionally weaker countries may struggle to meet common standards, while public scepticism toward fiscal integration limits political support. For these reasons, Europe is likely to continue operating with differentiated fiscal speeds.

3.5.1 Policy Proposals for Greater Fiscal Cohesion

Although full harmonisation remains unlikely, several proposals aim to strengthen coordination and reduce harmful competition.

A first proposal concerns reforming EU fiscal rules, making them more flexible and growth-oriented while maintaining credibility. A more realistic framework could reduce procyclical adjustments and support long-term investment.

A second proposal is the creation of a permanent EU-level fiscal capacity. A common stabilisation tool could help manage asymmetric shocks and support strategic investment, reducing divergence across member states.

A third area involves greater tax coordination. Incremental steps, such as minimum effective corporate tax rates, transparency in tax rulings, and a common tax base for multinationals, could limit aggressive tax competition and profit shifting.

Targeted investment programmes also play a key role. Expanding EU funding for productivity-enhancing reforms in weaker economies could reduce structural gaps and support convergence. Finally, institutional reforms that improve transparency and accountability would strengthen trust and governance capacity.

3.5.2 Lessons from the Recovery and Resilience Facility

The Recovery and Resilience Facility showed that joint fiscal action is possible in times of crisis. For the first time, the EU issued common debt to finance national recovery plans, setting a precedent for shared fiscal instruments.

The RRF also highlighted the importance of linking investment to structural reforms. By conditioning funding on reforms in key areas, the Facility promoted alignment between national policies and EU priorities.

At the same time, the RRF revealed structural limits. Differences in administrative capacity and implementation speed led to uneven results across member states. Moreover, political debates about moral hazard and long-term liabilities show that joint instruments remain controversial.

Overall, the RRF demonstrates both the potential and the limits of fiscal convergence: coordinated action can reduce divergence in exceptional circumstances, but deep and permanent integration remains politically fragile.

Chapter 4: Two Fiscal Europes – A Comparative Analysis of the High-Tax and Competitive-Tax Models

4.1 Introduction to the Comparative Framework

This chapter develops a comparative analysis of the two predominant fiscal models that currently coexist within the European Union: the high-tax coordinated model and the competitive-tax model. These models represent distinct approaches to taxation, economic governance, welfare provision, and institutional design. Their coexistence within a common market and monetary union provides essential insights into the structural drivers of Europe's "two fiscal speeds." By examining their characteristics, outcomes, and underlying logics, this chapter offers a systematic assessment of how divergent fiscal choices shape national trajectories and contribute to broader asymmetries within the EU.

The comparative framework adopted here is grounded in the recognition that fiscal models cannot be understood in isolation. They reflect interactions among economic structures, political institutions, social preferences, and historical legacies. High-tax coordinated economies rely on extensive welfare states, strong administrative capacity, and broad tax bases to promote social cohesion and long-term competitiveness. Competitive-tax economies, by contrast, use low corporate tax rates, flexible regulatory environments, and targeted incentives to attract investment and integrate into global value chains. These contrasting strategies lead to different patterns of growth, fiscal capacity, inequality, and institutional behaviour.

Because the aim of this chapter is to assess the implications of these divergent models, the comparative framework focuses on four analytical dimensions: fiscal indicators, economic performance, social outcomes, and institutional capacity.

Fiscal indicators include tax-to-GDP ratios, the structure of taxation, and reliance on specific revenue sources. Economic performance captures productivity, innovation, GDP growth, and the role of foreign direct investment. Social outcomes encompass inequality, labour market conditions, and welfare provision. Institutional capacity involves governance quality, administrative efficiency, and alignment with EU fiscal rules.

The comparative perspective also highlights the asymmetries that arise when different fiscal models operate within a shared economic and regulatory environment. The Single Market and the Economic and Monetary Union intensify the interactions between national fiscal strategies, amplifying both complementarities and tensions. While high-tax economies emphasise fairness, social protection, and institutional stability, competitive-tax economies prioritise agility, investment attraction, and global competitiveness. Understanding how these models coexist, and occasionally clash, provides valuable insight into the structural forces driving Europe's fiscal divergence.

This chapter is organised into four main sections. It begins by clarifying the purpose and relevance of the comparison, outlining why these two models are analytically central to understanding the EU's fiscal landscape. It then explains the selection of countries and the logic behind grouping Italy and Germany as representatives of the high-tax coordinated model, and Ireland and the Netherlands as exemplars of the competitive-tax model. The chapter proceeds by detailing the methodological framework used to compare these models, before examining each model in depth and presenting a cross-country comparative assessment.

Through this structured analysis, the chapter aims to illuminate how fiscal models contribute to the emergence of Europe's "two fiscal speeds," how they shape national development paths, and how they influence the broader political and institutional dynamics of the European Union. The findings presented here form the conceptual and empirical foundation for evaluating the challenges and opportunities of fiscal convergence discussed in the final chapters of the thesis.

4.1.1 Purpose and Relevance of the Comparison

This comparative analysis examines how the coexistence of the high-tax coordinated model and the competitive tax model shapes economic, social, and institutional outcomes within the European Union. The two paradigms embody distinct conceptions of state-market relations, welfare provision, and competitiveness, and their interaction within an integrated economic space contributes to structural fiscal divergence.

The comparison is relevant for three principal reasons.

First, the models generate different fiscal capacities and levels of macroeconomic resilience, influencing public investment, debt management, and shock absorption.

Second, they interact differently with the Single Market: competitive-tax systems attract mobile capital through fiscal incentives, while coordinated systems rely on institutional quality and human capital.

Third, fiscal divergence produces differentiated social outcomes and shapes Member States' positions in EU governance debates, particularly regarding harmonisation and fiscal coordination.

The analysis therefore provides a structured basis for understanding the emergence of "two fiscal speeds" and the constraints affecting deeper fiscal integration within the Union.

4.1.2 Selection of Countries and Grouping Logic

The selection of Italy and Germany as representatives of the high-tax coordinated model, and Ireland and the Netherlands as representatives of the competitive-tax model, is grounded in structural fiscal characteristics and policy orientation. The classification does not imply rigid typologies but identifies prevailing strategic approaches within the EU framework.

Italy and Germany are grouped under the high-tax coordinated model due to their comparatively elevated tax-to-GDP ratios, broad revenue bases, and welfare-oriented fiscal systems. Both prioritise redistribution, social protection, and state-supported competitiveness. Germany represents a fiscally disciplined and institutionally robust version of the model, whereas Italy illustrates the constraints that may arise under weaker fiscal space and higher debt exposure.

Ireland and the Netherlands exemplify the competitive-tax model through the strategic use of fiscal policy to attract mobile capital and multinational investment. Ireland relies on low corporate taxation and targeted incentives, while the Netherlands combines favourable tax rulings with administrative efficiency and financial intermediation capacity. Both operate as small, open economies integrated into global value chains.

The grouping logic also captures intra-model variation, allowing for comparison of institutional capacity, fiscal discipline, and growth dynamics within each paradigm. Together, the four cases provide a balanced framework for analysing the structural foundations and policy implications of Europe’s dual fiscal trajectory.

4.1.3 Methodology and Analytical Dimensions

The comparative analysis developed in this chapter adopts a structured case-study methodology aimed at identifying the defining characteristics, performance implications, and institutional foundations of the high-tax coordinated model and the competitive-tax model. Given the complexity of fiscal systems, the approach integrates quantitative indicators with qualitative institutional assessment, allowing for a multidimensional evaluation of fiscal divergence within the European Union.

The research design is based on a paired comparison of Italy and Germany (high-tax coordinated model) and Ireland and the Netherlands (competitive-tax model). This configuration enables both cross-model comparison and within-model variation, capturing structural asymmetries as well as internal heterogeneity.

The analytical framework is organised around four core dimensions:

1. Fiscal Structure and Sustainability
This dimension examines tax composition, tax-to-GDP ratios, revenue stability, public debt levels, and compliance with EU fiscal rules. It evaluates how fiscal architecture supports or constrains long-term macroeconomic stability.

2. Economic Performance and Competitiveness
Indicators include GDP growth, productivity, FDI inflows, industrial structure, and innovation capacity. The objective is to assess how fiscal strategies influence competitiveness, resilience, and integration within global markets.

3. Social Outcomes and Redistribution
This dimension evaluates welfare expenditure, labour market conditions, inequality, and redistributive capacity, analysing the extent to which fiscal models sustain social cohesion.

4. Institutional and Governance Capacity
Institutional quality, administrative efficiency, regulatory stability, and enforcement capacity are examined to determine how governance structures affect fiscal credibility and long-term sustainability.

Across these dimensions, the analysis applies comparative logic to identify systematic divergences that underpin the emergence of Europe's "two fiscal speeds." The framework ensures that fiscal performance is assessed not only in economic terms, but also through its social and institutional implications.

This methodological structure provides the foundation for the model-specific analysis developed in the following sections.

4.2 The High-Tax Coordinated Model: Italy and Germany

The high-tax coordinated model represents a fiscal and institutional approach centred on broad tax bases, high levels of public spending, and comprehensive welfare systems designed to promote social cohesion and long-term economic stability. Italy and Germany are among the most illustrative examples of this model within the European Union, even though their economic performance and institutional capacities differ significantly. Both countries rely on substantial taxation and social contributions to finance extensive public services, but their divergent structural conditions produce different outcomes within a shared fiscal paradigm. The analysis below draws on recent comparative indicators from OECD and Eurostat, incorporated narratively.

Germany represents a strong and stable version of the high-tax coordinated model. Its high levels of taxation and social contributions are supported by a competitive industrial base, strong productivity, and well-functioning institutions. These factors allow the German state to maintain long-term fiscal discipline while financing an extensive welfare system and robust public services. Italy, by contrast, shares the core characteristics of the model, high taxation, large public spending, extensive welfare commitments, but operates under more restrictive economic and institutional conditions. Persistent productivity gaps, regional disparities, and a high public debt burden reduce Italy’s fiscal space and weaken the state's ability to convert high revenues into long-term competitiveness.

To anchor this comparison, Table 4.2 presents a set of aligned fiscal, economic, and institutional indicators that clearly distinguish high-tax coordinated economies from competitive-tax models examined later in the chapter. All indicators included are directly comparable with the table presented for Ireland and the Netherlands, ensuring analytical coherence.

Table 4.2 — High-Tax Coordinated Model: Italy and Germany (Selected Fiscal and Structural Indicators, 2023)

Indicator	Italy (High-Tax Model)	Germany (High-Tax Model)
Tax-to-GDP Ratio (2023)	42.8% – very high	38.1% – high and stable
Corporate Tax Rate (Statutory)	24% (IRES)	≈30% (combined CIT + trade tax)
Effective Corporate Taxation	Medium–high	High
Public Spending (% of GDP)	≈48%	≈51%
Social Contributions (% of GDP)	≈13%	≈17% – among the highest in Europe
Economic Structure	Mixed competitiveness; productivity gaps	Highly competitive manufacturing and innovation
Institutional Quality	Fragmented, uneven administrative capacity	Strong, stable, high-capacity administration

***Source**: Author's elaboration based on Eurostat Government Finance Statistics, OECD Tax Database, OECD Revenue Statistics, and World Bank Worldwide Governance Indicators (2023 data).*

The table highlights the core features that define Italy and Germany as high-tax coordinated economies. Both countries maintain high tax-to-GDP ratios, elevated social contributions, and substantial levels of public spending, hallmarks of a fiscal model that prioritises welfare provision, institutional coordination, and long-term investment. These structural characteristics clearly distinguish them from competitive-tax economies, where tax-to-GDP ratios and social contributions are markedly lower.

Despite sharing these core traits, Italy and Germany's outcomes diverge due to differences in institutional strength and economic structure. Germany's strong regulatory environment, competitive industrial base, and high R&D investment enable it to sustain a high-tax system while maintaining fiscal discipline and international competitiveness. Italy's high-tax framework, however, is constrained by slower productivity growth, regional inequality, and administrative complexity, which reduce the effectiveness of public spending and weaken the sustainability of its welfare commitments.

Together, Italy and Germany offer a nuanced understanding of how the high-tax coordinated model operates under different structural conditions. Their comparison demonstrates that while this model can support robust welfare systems and long-term stability, its success depends heavily on institutional capacity, economic dynamism, and the ability to align public revenues with strategic investment priorities. These insights are essential for understanding the broader divergence within the EU and for contrasting high-tax models with the competitive-tax strategies analysed in the following section.

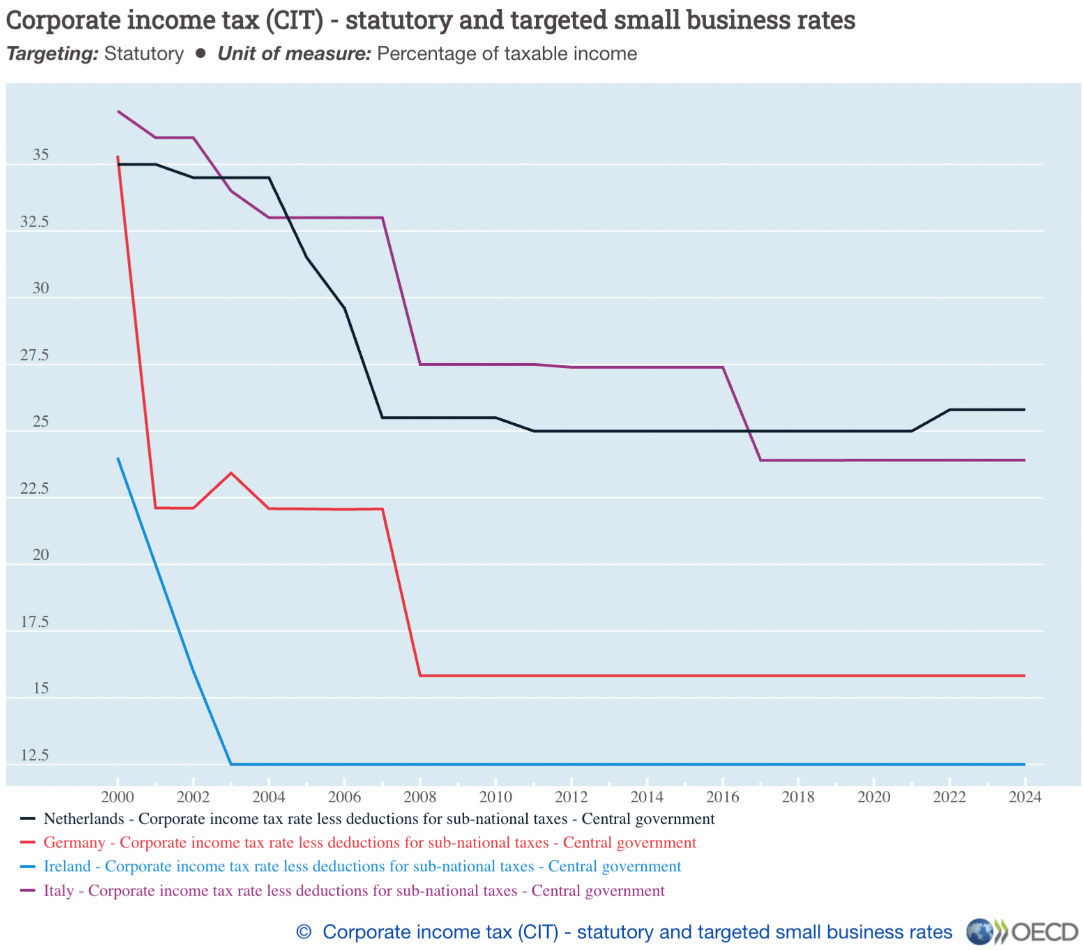
4.2.1 Fiscal Structure and Taxation Profile

The fiscal architecture of Italy and Germany reflects the defining features of the high-tax coordinated model, characterised by broad tax bases, diversified revenue sources, and a structurally significant role for labour and social contributions. While both countries operate within this coordinated paradigm, their taxation profiles reveal meaningful internal divergence.

Labour taxation represents a major source of revenue in both systems. In Italy, the high incidence of social contributions contributes to elevated labour costs and persistent distortions in employment incentives. Germany similarly relies on labour taxation, but stronger institutional coordination, higher employment rates, and greater productivity mitigate its distortionary effects.

Corporate taxation provides a clearer illustration of structural positioning within the European fiscal landscape.

Figure 4.2.1 – Statutory Corporate Income Tax Rates (CIT), Central Government (% of Taxable Income), 2000–2024



***Source**: OECD (2024), Corporate income tax (CIT) – statutory and targeted small business rates**,** OECD Tax Database. Author's elaboration.*

Figure 4.2.1 presents the evolution of statutory corporate income tax (CIT) rates (central government, less deductions for sub-national taxes) for Germany, Italy, Ireland, and the Netherlands between 2000 and 2024. The legend clarifies the distinct national trajectories.

The figure shows that Germany maintained a comparatively high statutory rate throughout the period, stabilising around 25–30%, consistent with its coordinated, high-revenue fiscal structure. Italy followed a similar high-rate profile until significant reductions in the mid-2000s, before stabilising at approximately 24%.

By contrast, Ireland adopted a structurally low corporate tax rate (12.5%) from the early 2000s onward, maintaining it consistently as a strategic instrument of capital attraction. The Netherlands, while positioned between the two models, implemented gradual reductions over time, reflecting competitive adjustments within the Single Market framework.

The divergence illustrated in Figure 4.2.1 is not cyclical but structural. It reflects distinct fiscal strategies regarding the taxation of mobile capital. Germany and Italy prioritise revenue stability and redistribution within coordinated welfare systems, whereas Ireland exemplifies a competitive-tax approach designed to enhance investment attractiveness.

Beyond corporate taxation, differences in VAT design, compliance efficiency, and administrative capacity further differentiate the two coordinated systems. Germany's diversified and efficient tax base benefits from strong macroeconomic performance and high compliance rates. Italy's fiscal structure operates under tighter constraints due to slower growth, demographic pressures, and persistent challenges in tax enforcement.

Overall, while Italy and Germany share the institutional foundations of the high-tax coordinated model, the evidence confirms that fiscal outcomes depend heavily on economic performance and governance quality. The comparison, reinforced by Figure 4.2.1, illustrates how structural taxation choices contribute to Europe's broader two-speed fiscal dynamic.

4.2.2 Public Debt, Fiscal Discipline and Budgetary Dynamics

Public debt constitutes a decisive variable in explaining the internal divergence of the high-tax coordinated model. Although Italy and Germany share comparable revenue capacities and welfare commitments, their fiscal sustainability differs markedly. This divergence shapes macroeconomic stability, borrowing conditions, and policy autonomy within the EU framework.

Germany maintains a debt level of approximately 63% of GDP, close to the Maastricht reference value and well below the levels observed during the sovereign debt crisis. This position reflects sustained fiscal discipline, supported by strong economic performance and institutionalised budgetary constraints such as the *Schuldenbremse*. The constitutional debt brake limits structural deficits and reinforces medium-term fiscal planning, enhancing credibility and reducing sovereign risk premia. As a result, Germany preserves countercyclical capacity and can accumulate fiscal buffers during expansionary phases.

Italy, by contrast, exhibits a debt ratio of around 138% of GDP, among the highest in the European Union. This level reflects long-standing structural imbalances linked to modest productivity growth, demographic pressures, and historically high interest expenditure. Elevated debt constrains fiscal space, increases sensitivity to market conditions, and limits the government's ability to pursue expansionary policies without raising concerns about sustainability. Unlike Germany, Italy operates under tighter intertemporal budget constraints that reduce its capacity to smooth economic cycles effectively.

Budgetary dynamics further reinforce this asymmetry. Germany has historically achieved greater alignment between fiscal outcomes and medium-term objectives, often generating surpluses during periods of strong growth. This countercyclical behaviour strengthens resilience during shocks. Italy, in contrast, faces structural rigidities that complicate fiscal adjustment, making consolidation more vulnerable to political and economic pressures.

The contrast demonstrates that identical fiscal architectures do not guarantee equivalent outcomes. Within the high-tax coordinated model, institutional strength and macroeconomic performance determine whether substantial public revenues translate into sustainable debt dynamics. Germany's fiscal framework reinforces stability and credibility within EU governance structures, whereas Italy's high debt burden constrains strategic flexibility and contributes to its placement on the slower side of Europe's two-speed trajectory.

4.2.3 Economic Structure and Competitiveness

Italy and Germany represent two distinct economic configurations within the high-tax coordinated model. While both rely on regulated labour markets, social partnership, and long-term industrial coordination, their competitiveness trajectories diverge markedly due to structural differences in productivity, innovation capacity, and industrial composition.

Germany's economic structure is characterised by a strong manufacturing base, high export orientation, and sustained investment in research and development (above 3% of GDP). The *Mittelstand* and dense industrial clusters support technological upgrading and global integration. Close coordination between firms, vocational training systems, and labour institutions ensures skill formation aligned with industrial needs. This institutional coherence reinforces productivity growth and sustains Germany’s competitive position within global value chains.

Italy, by contrast, exhibits a more fragmented productive structure. Although it maintains internationally competitive sectors—particularly in machinery, automotive components, fashion, and agri-food—average firm size remains smaller and investment in R&D significantly lower than in Germany. Productivity growth has stagnated since the early 2000s, reflecting limited technological diffusion, slower digital transformation, and structural barriers to firm expansion. Regional disparities further weaken aggregate competitiveness, as infrastructure gaps and administrative inefficiencies constrain convergence.

Productivity represents the central fault line between the two economies. Germany’s sustained technological upgrading supports stable wage growth, export strength, and fiscal resilience. Italy’s persistent productivity stagnation limits potential growth and reduces the effectiveness of its coordinated fiscal framework. In this context, similar levels of taxation and welfare commitment generate different macroeconomic outcomes because they operate within structurally unequal productive systems.

The divergence in economic structure ultimately reinforces the broader two-speed dynamic. Germany’s institutional alignment between industry, innovation, and labour markets produces a virtuous cycle of competitiveness and fiscal stability. Italy’s structural rigidities, by contrast, constrain the capacity of the coordinated model to translate high public revenue into sustained economic performance.

4.2.4 Welfare State and Social Protection Systems

The welfare systems of Italy and Germany represent central pillars of the high-tax coordinated model. Both countries allocate a substantial share of GDP to social protection, yet the effectiveness and long-term sustainability of their welfare regimes diverge markedly due to structural and institutional asymmetries.

Germany combines high social expenditure (approximately 26% of GDP) with strong labour market performance and a stable contribution-based financing structure. Its insurance-based model integrates pensions, healthcare, unemployment protection, and long-term care within a coherent institutional framework. High employment rates and well-developed activation policies enhance fiscal sustainability and reinforce redistributive efficiency. In this configuration, social protection operates not only as a mechanism of redistribution but also as a stabilising component of macroeconomic resilience.

Italy devotes a comparable share of GDP to social spending; however, expenditure is disproportionately concentrated in pensions. Demographic ageing, lower labour market participation, and persistent regional disparities exert structural pressure on welfare finances. Unlike Germany, Italy struggles to translate high expenditure into equivalent redistributive effectiveness. Labour market duality, youth unemployment, and uneven administrative capacity weaken activation policies and limit poverty reduction outcomes.

Healthcare provision further reflects this divergence. Germany's coordinated insurance framework ensures relatively uniform service quality, whereas Italy's universal system, despite broad coverage, exhibits significant territorial inequalities linked to fiscal and administrative fragmentation.

These contrasts illustrate that expenditure levels alone do not determine welfare performance. Institutional coherence, labour market dynamics, and fiscal sustainability ultimately shape the capacity of the high-tax coordinated model to function as a stabilising framework. Germany's welfare regime reinforces fiscal resilience, while Italy's operates under tighter structural constraints, contributing to its placement within Europe's two-speed trajectory.

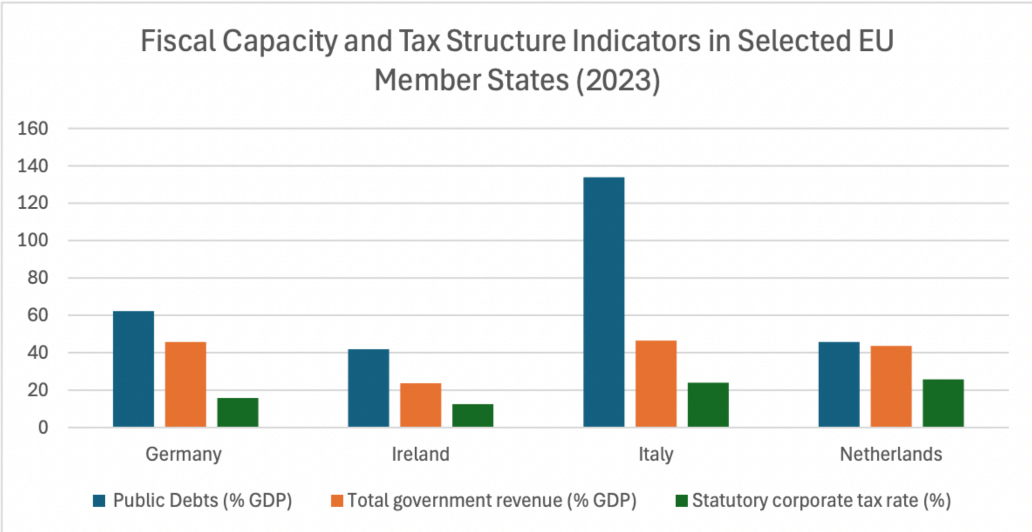
4.2.5 Institutional Strength and Governance Quality

The relationship between governance quality and fiscal performance is not merely theoretical; it translates into measurable differences in fiscal capacity and debt sustainability. Stronger institutional environments enhance revenue collection efficiency, improve expenditure control, and reinforce compliance with EU fiscal rules. Conversely, institutional fragmentation weakens policy execution and reduces the effectiveness of fiscal consolidation strategies.

These dynamics become visible when examining aggregate fiscal indicators. As shown in **Figure 4.2.5**, Germany combines moderate public debt with a high and stable revenue ratio, reflecting a governance structure capable of sustaining fiscal commitments while preserving macroeconomic stability. Italy, by contrast, displays significantly higher debt levels despite comparable revenue performance, suggesting that institutional constraints limit the translation of fiscal capacity into long-term sustainability. Ireland and the Netherlands, operating within more competitive-tax frameworks, exhibit lower debt ratios and differentiated tax structures, reinforcing the broader pattern of fiscal divergence within the Union.

Figure 4.2.5 – Fiscal Capacity and Tax Structure Indicators in Selected EU Member States (2023)

Public debt (% GDP), total government revenue (% GDP), and statutory corporate tax rate (%)



Source*: Eurostat (2026); OECD (2026). Author's elaboration.*

In this sense, the empirical evidence does not simply illustrate fiscal differences; it substantiates the structural argument advanced throughout this chapter: institutional strength directly shapes fiscal resilience and ultimately determines a country's position within Europe's two-speed dynamic.

4.3 The Competitive-Tax Model: Ireland and the Netherlands

The competitive-tax model represents a fundamentally different approach to fiscal policy and economic strategy compared to high-tax coordinated systems. Whereas coordinated economies rely on broad tax bases and substantial public spending to sustain welfare and institutional stability, competitive-tax economies use fiscal policy as an active tool to attract investment, integrate into global value chains, and foster high-value economic activity. Ireland and the Netherlands exemplify this model within the European Union, though each applies it through different mechanisms. Their experiences illustrate how small, open economies can leverage fiscal competitiveness to compensate for structural constraints and position themselves as strategic hubs within the global economy.

Ireland is the paradigmatic competitive-tax economy. Its development model has centred on maintaining one of the lowest corporate tax rates in the EU, coupled with a business-friendly regulatory environment and targeted incentives for multinational enterprises. These policies have transformed Ireland into a global hub for technology, pharmaceuticals, and financial services. The country's economic performance, though highly influenced by multinational accounting practices, reflects strong FDI-driven growth and high employment levels. However, Ireland's reliance on multinational profits also creates exposure to external volatility and international tax reforms.

The Netherlands adopts a more diversified version of the competitive-tax model. Rather than relying solely on low corporate taxation, the Dutch system provides a sophisticated fiscal framework including favourable tax rulings, extensive networks of double-taxation treaties, an attractive holding company regime, and efficient administrative procedures. These features have made the Netherlands a gateway for global capital flows and an attractive location for multinational headquarters, financial services, and logistics operations. At the same time, the Netherlands maintains moderate tax levels and a diversified economic base, complementing its competitive fiscal instruments with strong institutional capacity and advanced infrastructure.

To clarify the defining features of the competitive-tax model and ensure comparability with the high-tax coordinated table, Table 4.3 presents a set of aligned indicators that highlight the fiscal, economic, and institutional characteristics of Ireland and the Netherlands. These indicators mirror those used for Italy and Germany, allowing for direct cross-model comparison.

Table 4.3 — Competitive-Tax Model: Ireland and the Netherlands (Selected Fiscal and Structural Indicators, 2023)

Indicator	Ireland (Competitive-Tax Model)	Netherlands (Competitive-Tax Model)
Tax-to-GDP Ratio (2023)	≈31% – low	≈39% – medium, but tax-competitive structure
Corporate Tax Rate (Statutory)	12.5% – lowest in the EU	25.8%, but effective rates reduced via rulings
Effective Corporate Taxation	8–9% – extremely low	12–14% – favourable through planning mechanisms
Public Spending (% of GDP)	≈42% – lower than high-tax models	≈45%, still below coordinated systems
Social Contributions (% of GDP)	≈5–6%, far lower than high-tax systems	≈12%, below Germany and Italy
Economic Structure	Highly dependent on multinationals in tech and pharma	Diversified; major financial and logistics hub
Institutional Quality	Very high regulatory efficiency	Very high institutional capacity and administrative effectiveness

Source: *Author's elaboration based on OECD Revenue Statistics (2023), Eurostat Government Finance Statistics (2023), European Commission* Taxation Trends in the European Union *(2023),* *OECD* Corporate Tax Statistics *(2023), OECD* Main Science and Technology Indicators *(2023), and World Bank* Worldwide Governance Indicators *(2023).*

These indicators clearly situate Ireland and the Netherlands within the competitive tax model. Their low tax-to-GDP ratios, favourable corporate tax environments, and lower levels of social contributions contrast sharply with the fiscal profiles of high-tax coordinated economies. At the same time, both countries combine fiscal competitiveness with strong institutional quality, which enhances their ability to attract multinational enterprises and integrate into global economic networks.

Despite these common features, Ireland and the Netherlands represent two distinct variants of the competitive-tax approach. Ireland relies more heavily on statutory tax incentives and the presence of multinational corporations, leading to rapid but externally dependent growth. The Netherlands adopts a more balanced model in which favourable tax instruments complement a diversified, innovation-oriented economy with strong governance capacity. Together, they illustrate the internal flexibility of the competitive-tax model, and the different ways small, open economies can leverage fiscal strategy to drive economic performance.

By contrasting these findings with those for Italy and Germany, the analysis highlights the structural asymmetries between Europe's two fiscal models. Competitive-tax economies prioritise investment attraction and global integration, often resulting in dynamic growth and high employment, but also exposing them to volatility and policy scrutiny within the EU. Their fiscal strategies, and the institutional frameworks that support them, play a central role in shaping Europe's two fiscal speeds and the broader tensions surrounding tax competition and regulatory harmonisation.

4.3.1 Corporate Tax Strategies and Investment Attraction

Corporate tax strategy lies at the core of the competitive-tax model, and Ireland and the Netherlands offer two of the most influential and internationally recognised examples within the European Union. Both countries employ taxation not merely as a tool for revenue generation but as an active instrument of economic policy designed to attract multinational enterprises, stimulate investment, and position themselves within global value chains. While their approaches differ, they converge on the idea that fiscal competitiveness can compensate for structural limitations such as small domestic markets, geographic peripherality (in Ireland's case), or high openness to global capital flows (in the Netherlands).

Ireland has long been associated with one of the lowest statutory corporate tax rates in the EU, 12.5%, a cornerstone of its development strategy since the 1990s. This low rate is complemented by targeted incentives, R&D credits, favourable intellectual property (IP) tax regimes, and a streamlined regulatory environment. These measures have attracted some of the world's largest technology, pharmaceutical, and financial companies, generating substantial inflows of foreign direct investment. In practice, Ireland's **effective** corporate tax rates often fall below statutory levels, partly due to multinational profit-shifting and the utilisation of specific tax provisions. Although Ireland has implemented reforms in response to international pressure, including the OECD/G20 Base Erosion and Profit Shifting (BEPS) framework, it remains one of the most competitive corporate tax jurisdictions in Europe.

The Netherlands employs a different version of competitive tax strategy. While its statutory corporate tax rate (25.8%) is significantly higher than Ireland's, the effective burden can be substantially lower due to a wide array of fiscal instruments. Dutch competitive advantage stems from its **extensive network of tax treaties**, the favourable treatment of holding companies, and the use of **advance tax rulings** that provide predictability and legal certainty for multinational enterprises. The Netherlands also offers an attractive innovation box regime, reducing effective tax rates on income derived from intellectual property. As a result, the country has become a central hub in global corporate structures, particularly for financial intermediation, intellectual property management, and profit allocation across multinational groups.

Both countries integrate corporate tax strategy into a broader institutional environment characterised by regulatory efficiency, administrative clarity, and pro-business governance. In Ireland, the combination of low tax rates and a highly flexible labour market attracts multinational firms seeking to scale rapidly within the EU Single Market. In the Netherlands, the tax system is embedded in a diversified economic structure with advanced logistics, strong digital infrastructure, and a reputation for predictable regulatory practices. These conditions enable multinational enterprises to operate with stability and efficiency, reinforcing each country's attractiveness as an investment destination.

However, the aggressive use of tax competitiveness has also generated political and regulatory challenges. Ireland and the Netherlands have faced increasing scrutiny from EU institutions, the OECD, and national governments concerned about profit shifting, tax base erosion, and distortions of competition within the internal market. The European Commission has, in recent years, intensified its examination of tax rulings, preferential regimes, and the broader impact of fiscal competition on the functioning of the Single Market. These debates reflect the growing tension between national fiscal autonomy and the need for coordinated EU responses to cross-border tax strategies.

Despite this scrutiny, Ireland and the Netherlands continue to demonstrate the economic effectiveness of competitive-tax policies. Their capacity to attract multinational enterprises has driven high employment rates, robust export performance, and significant contributions to GDP. At the same time, these gains highlight the structural asymmetries between competitive-tax and coordinated high-tax models and underscore the broader challenges facing the EU as it seeks to balance fiscal competition with fair and sustainable economic governance.

4.3.2 Public Finances and Fiscal Balance

The public finances of Ireland and the Netherlands reflect the structural features of the competitive-tax model and the economic strategies underpinning it. Although both countries maintain fiscally sustainable positions, their budgetary dynamics differ substantially from those of high-tax coordinated economies such as Italy and Germany. Competitive-tax systems rely on lower overall tax burdens, more targeted fiscal instruments, and a strategic alignment of public spending with economic openness and investment attraction. These characteristics shape the fiscal balance, revenue structure, and resilience of Ireland and the Netherlands in distinct ways. The analysis draws on recent Eurostat Government Finance data and OECD fiscal indicators.

Ireland's fiscal position has undergone profound transformation over the past two decades. Once heavily indebted after the financial crisis of 2008, the country has substantially improved its fiscal sustainability, with public debt falling to approximately 42% of GDP, well below the EU average. This improvement reflects a combination of FDI-driven growth, strong labour market performance, and substantial corporate tax revenues. However, a central feature of Irish public finances is their **high dependence on multinational profits**, which account for an unusually large share of corporate tax receipts. This makes Ireland's revenue base more volatile and susceptible to external shocks, as changes in global corporate taxation, profit allocation practices, or multinational investment strategies can significantly affect government revenues. Recent fiscal analyses stress the importance of using surplus revenues for long-term fiscal buffers, given the inherent unpredictability of this revenue stream.

The Netherlands presents a more balanced fiscal profile. Public debt levels remain moderate, around 49% of GDP, and fiscal outcomes are generally stable, supported by a diversified economy and consistent institutional performance. Unlike Ireland, where corporate taxes play a disproportionately large role, Dutch public finances rely on a more even distribution across consumption taxes, social contributions, and income taxation. Nonetheless, the Netherlands still benefits significantly from its role as a global financial and corporate hub, with tax rulings and multinational structures contributing to the country's revenue inflows. This strategic position supports fiscal capacity while maintaining overall tax levels that remain competitive within the EU context.

A key distinction between the two countries concerns **fiscal vulnerability**. Ireland's revenue structure creates exposure to international developments such as global minimum tax reforms, changes in corporate profit allocation, and increased scrutiny of aggressive tax planning. Although the Netherlands shares some exposure due to its financial intermediation role, its broader tax base and stronger institutional diversification reduce the risks associated with fluctuations in multinational activity. As a result, the Netherlands exhibits greater fiscal stability and lower sensitivity to shifts in the international tax landscape.

Both Ireland and the Netherlands maintain public spending levels below those observed in high-tax coordinated economies. This fiscal restraint is not necessarily indicative of weaker welfare systems but reflects alternative strategic priorities. Competitive-tax models prioritise investment in infrastructure, digitalisation, innovation frameworks, and regulatory efficiency rather than expansive social spending. This spending composition supports long-term competitiveness but results in less extensive welfare provision compared to countries such as Italy and Germany. Nonetheless, both Ireland and the Netherlands have invested heavily in targeted areas, such as education, transport, and digital infrastructure, that enhance their status as strategic hubs within global value chains.

Overall, the public finances of Ireland and the Netherlands reveal how competitive tax models can maintain fiscal sustainability despite lower tax burdens. Their fiscal structures, supported by strong institutional quality and economic openness, enable them to balance competitiveness with prudent budgetary management. However, their reliance, especially in Ireland's case, on multinational activity introduces distinct vulnerabilities that must be managed carefully in the context of global tax reforms and evolving EU regulatory frameworks. These characteristics illustrate the strengths and limitations of the competitive-tax model and differentiate it clearly from the budgetary dynamics of high-tax coordinated economies.

4.3.3 Economic Performance and Innovation Drivers

The economic performance of Ireland and the Netherlands reflects the distinctive characteristics of the competitive-tax model, which relies on external integration, multinational activity, and strategic specialisation to generate growth. Both economies display strong output performance, high employment levels, and substantial participation in global value chains, yet the drivers underpinning their success differ in important ways. Their innovation ecosystems, levels of technological adoption, and sectoral specialisation patterns reveal the structural mechanisms through which competitive-tax economies sustain long-term growth. This analysis draws on OECD productivity and innovation indicators, Eurostat national accounts, and European Commission competitiveness reports.

Ireland's economic performance is heavily shaped by the activities of multinational enterprises, particularly in high-value sectors such as technology, pharmaceuticals, and medical devices. Although headline GDP growth is often inflated by profit-shifting practices and intellectual property relocations, alternative measures such as modified gross national income (GNI*) provide a more accurate picture of underlying economic performance. These measures reveal steady and robust growth driven by export-intensive industries, high-skilled employment, and rising productivity within multinational-dominated sectors. Ireland's innovation performance is closely tied to foreign firms, which account for the majority of R&D expenditure and technological capability within the country. While this model ensures rapid technological diffusion and integration into global innovation networks, it also reduces the domestic economy's capacity for independent innovation and exposes Ireland to strategic decisions made by multinational headquarters.

The Netherlands exhibits a more balanced and diversified economic structure. Its economic performance reflects strong trade integration, advanced logistics, a competitive services sector, and a solid industrial base. The Port of Rotterdam, one of the busiest in the world, and the country's extensive digital and transport infrastructure enhance its role as a key gateway for European and global commerce. Dutch productivity levels remain among the highest in the European Union, supported by a highly skilled workforce and strong institutional frameworks. Unlike

Ireland, the Netherlands combines multinational-driven innovation with robust domestic R&D capabilities, supported by universities, research institutes, and a mature ecosystem for technology-intensive industries. R&D expenditure represents around 2.3% of GDP and continues to grow, demonstrating a sustained commitment to innovation-led competitiveness.

Innovation drivers further distinguish the two countries. Ireland's innovation system is characterised by **concentrated excellence**, where a small number of global firms account for the majority of scientific output, R&D activity, and technological capability. This creates a dynamic environment for high-tech sectors but leaves gaps in domestic innovation capacity, particularly among small and medium-sized enterprises. The Netherlands, by contrast, benefits from a **broad-based innovation ecosystem**, combining public investment, private sector leadership, and strong collaboration between firms, research institutions, and government. Dutch innovation strengths are evident across multiple domains, including life sciences, renewable energy technologies, advanced engineering, and digital services.

Labour market conditions also reinforce economic and innovation performance. Both economies exhibit high employment rates and flexible labour markets, but the Netherlands demonstrates a more stable relationship between employment, productivity, and sectoral diversification. Ireland relies more heavily on highly skilled labour associated with multinational enterprises, creating a dual economy in which productivity and wages differ significantly between domestic and foreign-owned firms.

Overall, the economic performance of Ireland and the Netherlands demonstrates the strengths of the competitive-tax model in delivering high growth, strong employment, and rapid technological adoption. However, the model's effectiveness depends heavily on external integration and the capacity to attract and retain multinational activity. Ireland's growth trajectory is more volatile and externally dependent, while the Netherlands benefits from a more diversified economic and innovation base. These differences illuminate the broader dynamics of Europe's two fiscal speeds and highlight how fiscal competitiveness interacts with structural characteristics to shape economic outcomes.

4.3.4 Welfare and Social Expenditure Models

Welfare and social expenditure patterns in Ireland and the Netherlands reflect the structural logic of the competitive-tax model, where fiscal policy prioritizes investment attraction, economic openness, and regulatory efficiency over extensive welfare commitments. Although both countries maintain welfare systems capable of supporting social cohesion, the scale, design, and objectives of these systems differ markedly from those found in high-tax coordinated economies such as Italy and Germany. Their welfare states are smaller relative to GDP, more targeted, and more closely aligned with labour market incentives and economic competitiveness. The analysis presented here draws on OECD Social Expenditure data, Eurostat social protection indicators, and European Commission country assessments.

Ireland's welfare model is relatively modest in size, with public social expenditure representing a lower share of GDP compared to high-tax coordinated systems. Its welfare architecture is shaped by demographic trends, labour market dynamics, and the structure of its economy. A significant portion of Irish welfare spending is directed toward income support, housing assistance, and social protection measures designed to mitigate inequality and facilitate labour market participation. While Ireland provides universal entitlements in certain areas, such as free primary education and public healthcare (largely delivered through a mixed system), its welfare state is less expansive and less financially demanding than those of continental European countries. The comparatively low level of social contributions, among the lowest in the EU, reflects the broader design of Ireland's competitive fiscal system.

The Netherlands maintains a more developed welfare state than Ireland but still operates within a framework that prioritizes competitiveness and fiscal sustainability. Dutch social expenditure is moderate relative to coordinated economies and is structured around a mix of public insurance schemes, employer-based contributions, and targeted social policies. The Dutch welfare model places strong emphasis on labour market integration, preventive healthcare, and activation policies designed to reduce long-term dependency. The country's combination of universal coverage and market-based elements, particularly in healthcare and pensions, reflects a hybrid approach that balances social protection with economic flexibility. This hybrid model is supported by high institutional capacity and administrative efficiency, enabling the Netherlands to deliver high-quality welfare services without the fiscal pressures typical of high-tax economies.

A key distinction between the two countries lies in their **relationship between welfare provision and economic structure**. In Ireland, the dual nature of the economy, where high-productivity multinational sectors coexist with lower-productivity domestic sectors, contributes to income inequality and uneven access to social benefits. Welfare policy plays a compensatory role, aiming to reduce disparities while supporting transitions into employment. In the Netherlands, welfare provision is more tightly integrated with labour market institutions, resulting in higher employment rates, lower long-term unemployment, and a more even distribution of social outcomes.

Healthcare systems further illustrate the differences in welfare design. Ireland's healthcare system, though moving toward greater universalism, still involves substantial private provision and out-of-pocket payments, contributing to inequality in access and waiting times. The Netherlands operates a highly regulated competitive insurance market that provides universal coverage through private insurance funds, supported by income-based contributions and state subsidies. This system balances universal access with efficiency, achieving high levels of service quality and patient satisfaction.

Both Ireland and the Netherlands maintain welfare systems that are leaner and more targeted than those of high-tax coordinated economies. Their models aim to preserve fiscal space for economic competitiveness while ensuring essential social protection. However, these systems also face challenges: Ireland confronts issues related to inequality, housing costs, and fragmentation in healthcare delivery; the Netherlands faces fiscal pressures associated with ageing and rising healthcare expenditure. Nevertheless, their welfare designs align with the broader strategic objectives of competitive-tax economies, flexibility, efficiency, and support for high employment.

Overall, the welfare and social expenditure models of Ireland and the Netherlands demonstrate how competitive-tax economies balance economic openness with social cohesion. Their relatively smaller welfare states, combined with strong labour market institutions and high-quality public administration, distinguish them clearly from high-tax coordinated economies and contribute to Europe's two-speed fiscal dynamic.

4.3.5 Institutional Characteristics and EU Compliance

Institutional characteristics play a decisive role in shaping the functioning and sustainability of the competitive-tax model. Ireland and the Netherlands combine high institutional capacity with regulatory frameworks designed to accommodate openness, foreign investment, and fiscal competitiveness. Their institutions not only support the smooth functioning of competitive tax regimes but also mediate the relationship between national fiscal autonomy and the broader regulatory expectations of the European Union. Understanding these institutional features is essential for assessing how competitive-tax economies navigate the constraints and opportunities of the EU Single Market. The analysis presented here draws on the European Commission's rule-of-law assessments, OECD governance reviews, and comparative indicators from the World Bank.

Both Ireland and the Netherlands rank among the highest-performing EU member states in terms of regulatory quality, government effectiveness, and rule of law. Their public administrations are characterised by professionalism, low levels of corruption, and well-developed mechanisms for policy implementation. These features are particularly important for competitive-tax economies, as multinational enterprises place high value on legal certainty, efficient regulation, and predictable administrative environments. Ireland's pro-business climate is supported by transparent rule-making, flexible labour institutions, and efficient regulatory agencies. The Netherlands, similarly, benefits from a long tradition of administrative reliability, consensus-based policymaking, and sectoral coordination that enhances its attractiveness for international firms.

A distinctive institutional feature of both countries is the strategic use of **advance tax rulings** and cooperative compliance frameworks. In the Netherlands, advance pricing agreements and advance tax rulings provide multinational firms with predictable tax outcomes, facilitating complex cross-border transactions and intra-group arrangements. Ireland also offers advance rulings, though to a more limited extent, ensuring transparency and helping firms navigate domestic tax obligations. These instruments contribute to the competitive positioning of both countries but have drawn increasing scrutiny from EU institutions concerned with potential distortions of competition and aggressive tax planning.

EU compliance represents a key dimension of institutional performance for competitive-tax economies. While Ireland and the Netherlands are fully integrated into the EU's fiscal and regulatory architecture, they have frequently been at the centre of debates on tax competition, profit shifting, and the need for greater harmonisation within the Single Market. The European Commission has launched several investigations into tax arrangements involving multinational enterprises operating in both countries, examining whether certain rulings or selective advantages constitute unlawful state aid. These cases underscore the tension between national fiscal sovereignty and EU-level objectives aimed at ensuring fair competition and preventing tax base erosion.

Despite being subject to scrutiny, both Ireland and the Netherlands generally comply effectively with EU recommendations and regulatory requirements. Their strong institutional capacity allows them to adjust policies when necessary while maintaining core elements of their competitive-tax strategies. For instance, both countries have implemented reforms aligned with the OECD/G20 Base Erosion and Profit Shifting (BEPS) initiative and have adopted EU directives addressing transparency, information exchange, and anti-tax avoidance measures. These adjustments reflect a pragmatic approach that seeks to preserve competitiveness while aligning with evolving international standards.

The broader institutional context of each country further reinforces the functioning of their competitive-tax models. Ireland benefits from a flexible and English-speaking workforce, a legal system rooted in common law, and institutions oriented toward business facilitation. The Netherlands enjoys high administrative efficiency, a central geographical position within Europe, and deeply institutionalised cooperation between government, enterprises, and social partners. These institutional strengths enhance both countries' ability to sustain competitive tax frameworks and respond to emerging regulatory challenges.

Taken together, the institutional characteristics of Ireland and the Netherlands demonstrate that competitive-tax models rely not only on favourable fiscal regimes but also on strong and adaptive governance structures. Their high levels of regulatory quality, coupled with effective compliance with EU requirements, enable them to operate successfully within the Single Market while maintaining fiscal strategies distinct from high-tax coordinated economies. These institutional foundations help explain their influential role within Europe's two-speed fiscal landscape and the continuing debates surrounding tax harmonisation and fair competition.

4.4 Cross-Model Comparative Assessment

The comparison between high-tax coordinated economies (Italy and Germany) and competitive-tax economies (Ireland and the Netherlands) illustrates the profound fiscal, economic, social, and institutional asymmetries that underpin Europe's two-speed trajectory. While both models coexist within the same Single Market, they are built upon fundamentally different assumptions regarding taxation, competitiveness, welfare provision, and the role of the state. Understanding these divergences is crucial for assessing the dynamics of fiscal competition within the European Union and the challenges this creates for policy coordination.

The following comparative table synthesizes the indicators previously analysed in Sections 4.2 and 4.3, presenting a unified framework that highlights the defining features of each model. By aligning identical indicators across the four countries, the table makes visible the structural logic that differentiates coordinated high-tax systems from competitive low-tax ones.

Table 4.4 — Comparative Matrix of Fiscal, Economic and Institutional Indicators: High-Tax vs Competitive-Tax Models (Italy, Germany, Ireland, Netherlands, 2023)

Indicator	Italy (High-Tax)	Germany (High-Tax)	Ireland (Competitive-Tax)	Netherlands (Competitive-Tax)
Tax-to-GDP Ratio	42.8% (very high)	38.1% (high)	≈31% (low)	≈39% (medium, competitive structure)
Statutory Corporate Tax Rate	24%	≈30%	12.5%	25.8%
Effective Corporate Taxation	Medium–high	High	8–9% (very low)	12–14% (planning-optimised)
Public Spending (% of GDP)	≈48%	≈51%	≈42%	≈45%
Social Contributions (% of GDP)	≈13%	≈17% (very high)	5–6% (very low)	≈12%
Economic Structure	Mixed; productivity gaps	Competitive manufacturing and innovation	MNE-dominated (tech and pharma)	Diversified; financial hub
Innovation Capacity (R&D % GDP)	≈1.5%	≈3.1%	≈1.2%	≈2.3%
Institutional Quality	Fragmented	High-capacity	Very high	Very high
Fiscal Model Logic	High-tax coordinated	High-tax coordinated	Competitive low-tax	Competitive strategic-tax
Dependency Risk	Structural stagnation and high debt	Low	High dependence on MNE profits	Medium (financial flows)

***Source**: Author's elaboration based on Eurostat Government Finance Statistics (2023), OECD Revenue Statistics (2023), OECD Corporate Tax Statistics (2023), European Commission Taxation Trends in the EU (2023), and World Bank Worldwide Governance Indicators (2023).*

The comparative matrix reveals a **clear structural bifurcation** between Europe's two fiscal models. Italy and Germany demonstrate the logic of **high-tax coordinated economies**, where the state plays a central role in financing welfare systems, sustaining industrial capacity, and stabilising the macroeconomy. High tax-to-GDP ratios, elevated social contributions, and strong public spending underscore a fiscal model based on redistribution, social cohesion, and long-term investment. However, the outcomes diverge: Germany's institutional strength enables this model to perform efficiently, while Italy faces difficulty sustaining similar commitments under weaker structural conditions.

Ireland and the Netherlands, by contrast, embody the **competitive-tax model**, where fiscal policy functions as a strategic instrument to attract global capital and multinational enterprises. These economies feature low or optimised corporate taxation, lower social contributions, and a regulatory environment designed for international competitiveness. Their growth trajectories are more dynamic but also more exposed to external shocks and evolving international tax standards. Ireland, in particular, faces substantial vulnerability due to its heavy reliance on multinational profits.

The comparison illustrates that **Europe's fiscal divergence is not simply quantitative but structural**. High-tax systems rely on coordinated institutions, stable revenues, and extensive welfare provision; competitive-tax systems rely on openness, fiscal agility, and global integration. These differences create **asymmetrical advantages and constraints** across the Union:

- High-tax economies possess stronger welfare states but face challenges in competitiveness and fiscal flexibility.
- Competitive-tax economies achieve faster growth and investment attraction but confront sustainability risks and EU scrutiny.
- Institutional quality amplifies capacity: Germany and the Netherlands translate their models efficiently; Italy and Ireland face internal vulnerabilities.

Ultimately, the coexistence of these two models within a single market leads to **persistent fiscal asymmetries**, influencing capital flows, labour mobility, corporate location decisions, and bargaining power within the EU. The comparative assessment underscores why Europe continues to operate at **two fiscal speeds**, shaped not only by economic performance but by fundamentally different fiscal philosophies and institutional capacities.

4.4.1 Fiscal Comparison: Tax Burden and Revenue Models

The fiscal comparison between high-tax coordinated economies (Italy and Germany) and competitive-tax economies (Ireland and the Netherlands) reveals fundamentally different approaches to revenue generation, fiscal capacity, and the role of taxation within national development strategies. These differences shape public investment, welfare provision, institutional performance, and the broader dynamics of competitiveness within the European Union. Examining the tax burden and revenue models of the four case-study countries highlights the structural logic underlying Europe's two fiscal speeds.

High-tax coordinated economies rely on **broad and stable tax bases**, high levels of redistribution, and substantial social contributions. In both Italy and Germany, the tax-to-GDP ratio exceeds or approaches 40%, placing them among the highesttaxed economies in the EU. This fiscal structure supports large welfare systems, extensive public services, and long-term social and industrial policy objectives. Germany's tax system reflects institutional discipline and efficiency, enabling the state to convert high revenue into strategic investment. Italy, despite a similarly high burden, struggles to achieve comparable outcomes due to weaker productivity growth and administrative fragmentation. Nonetheless, both countries operate within a fiscal paradigm that assumes active state intervention and sustained public expenditure.

Competitive-tax economies adopt a contrasting strategy based on **fiscal competitiveness and selective tax incentives**. Ireland's tax-to-GDP ratio hovers around 31%, driven by a highly favourable corporate tax regime designed to attract multinational enterprises. Corporate taxation plays a disproportionately large role in revenue, creating a narrow but extremely lucrative tax base. The Netherlands, although featuring a tax-to-GDP ratio closer to the EU average, employs sophisticated mechanisms, such as tax rulings and advantageous treatment of holding companies, that effectively reduce the tax burden for multinational entities. These instruments make the Dutch revenue model competitive without lowering statutory rates to the level of Ireland.

A defining divergence emerges in the **composition of revenue**. In high-tax economies, social contributions represent a crucial component of public income, accounting for approximately 13% of GDP in Italy and up to 17% in Germany. These contributions sustain welfare systems and pension schemes but also increase labour costs, affecting employment dynamics and competitiveness. In competitive-tax systems, social contributions are significantly lower, around 5–6% of GDP in Ireland and 12% in the Netherlands, reflecting a model less reliant on labour taxation and more oriented toward consumption taxes and corporate revenue streams.

Another central distinction concerns the **balance between fiscal sustainability and fiscal vulnerability**. Germany's broad tax base and diversified revenue sources reinforce resilience, while Italy's high tax burden is offset by structural weaknesses that limit fiscal flexibility. Ireland's tax system, by contrast, generates substantial revenue from a narrow set of multinational-dominated sectors, exposing the country to volatility stemming from global corporate decisions or international tax reforms. The Netherlands faces less volatility due to its diversified economy but remains dependent on flows associated with multinational corporate structures.

These fiscal asymmetries produce different **policy incentives and constraints**. High-tax coordinated economies must maintain strong institutional capacity to ensure that high levels of taxation translate into public value. Competitive-tax economies must continuously balance low or optimised tax burdens with the need to sustain essential public services and comply with evolving EU and international tax regulations. These divergent fiscal philosophies shape public investment priorities, labour market policies, and the broader economic trajectory of each country.

In summary, the fiscal comparison highlights the deep structural divide between coordinated and competitive models. High-tax systems rely on comprehensive revenue mobilisation to sustain welfare and stability, while competitive-tax systems leverage fiscal attractiveness to integrate into global capital flows and stimulate growth. The coexistence of these models within a unified economic area contributes to the long-term persistence of Europe's two fiscal speeds, shaping intra-EU dynamics of competitiveness, taxation, and economic integration.

4.4.2 Economic and Competitiveness Comparison

The economic and competitiveness profiles of high-tax coordinated economies (Italy and Germany) and competitive-tax economies (Ireland and the Netherlands) differ profoundly, shaped by their contrasting fiscal systems, institutional capacities, and integration into global value chains. While high-tax systems rely on coordinated industrial structures, strong welfare institutions, and long-term public investment, competitive-tax systems achieve dynamism through foreign direct investment, fiscal agility, and global corporate networks. These divergent strategies generate asymmetrical patterns of productivity, innovation, and growth that reinforce Europe's two-speed economic landscape.

Germany embodies the strongest expression of the coordinated model. Its competitive advantage stems from a highly productive industrial base, dense network of export-oriented firms, and a vocational training system that ensures a continuous supply of skilled labour. Germany's high levels of R&D investment (around 3.1% of GDP), robust manufacturing sector, and institutional efficiency create a virtuous cycle: innovation supports competitiveness, which in turn sustains fiscal capacity. This coherence allows the country to maintain high taxation without compromising economic performance.

Italy, although part of the coordinated model, diverges significantly in outcome. Despite having important industrial districts and strong export niches, Italy faces decades-long productivity stagnation, regional disparities, and structural rigidities that weaken its competitiveness. Lower levels of R&D investment (around 1.5% of GDP) and persistent institutional fragmentation prevent the country from fully translating its fiscal commitments into growth. Italy illustrates how the coordinated model requires strong institutional foundations to remain competitive; without them, high taxation can become a constraint rather than a source of strength.

Competitive-tax economies achieve competitiveness through different mechanisms. Ireland's economic dynamism is driven primarily by multinational enterprises operating in high-value sectors such as technology, pharmaceuticals, and digital services. Productivity in these sectors is exceptionally high, but the domestic economy remains more modest in performance, creating a dual economic structure. While headline GDP growth can be volatile due to multinational accounting practices, underlying indicators (such as modified GNI*) reveal sustained, export-driven growth. Ireland's competitive advantage depends heavily on its ability to attract and retain global firms, making competitiveness closely tied to international tax frameworks and regulatory developments.

The Netherlands presents a more balanced expression of the competitive tax model. Its competitiveness derives from a diversified economic structure: advanced logistics, finance, digital services, and high-value manufacturing. As a major gateway for European trade, the Netherlands benefits from world-class infrastructure, including the Port of Rotterdam and a technologically advanced transport network. High institutional quality and strong integration into global value chains reinforce the country's competitive positioning. Moreover, Dutch innovation capacity, supported by R&D expenditure of around 2.3% of GDP, contributes to a stable and diversified competitive advantage that does not rely solely on multinational taxation strategies.

Across the four countries, the **drivers of competitiveness** differ systematically:

- **High-tax coordinated economies** leverage institutional cooperation, productive industrial ecosystems, and long-term investment.

- **Competitive-tax economies** leverage fiscal attractiveness, multinational networks, and global integration.

These differences produce **distinct productivity paths**. Germany consistently outperforms in productivity and innovation; Italy struggles to maintain competitiveness due to structural weaknesses; Ireland achieves exceptional productivity levels in multinational sectors but limited diffusion to the domestic economy; and the Netherlands combines strong productivity with diversified structural strengths.

The comparison also reveals asymmetries in **resilience**. Coordinated economies tend to be more stable but slower to adjust, while competitive-tax economies are more adaptive but also more exposed to external shocks. This creates different forms of vulnerability: Italy's is structural and long-term; Ireland's is externally driven by multinational decisions; Germany's resilience is institutional; and the Netherlands balances stability with exposure to international financial flows.

Overall, the economic and competitiveness comparison illustrates that Europe's fiscal divergence is not merely a matter of tax policy but reflects broader structural differences in how countries generate value, sustain productivity, and position themselves within the global economy. These divergent pathways reinforce the existence of Europe's two fiscal speeds and challenge the possibility of achieving convergence within a highly integrated Single Market.

4.4.3 Social Outcomes and Welfare Performance

The comparison of social outcomes and welfare performance across high-tax coordinated economies (Italy and Germany) and competitive-tax economies (Ireland and the Netherlands) reveals how fiscal structures translate into different models of social protection, inequality mitigation, and labour market inclusion. While all four countries are advanced European welfare states, their strategies and results diverge significantly, reflecting the underlying logic of their respective fiscal models.

High-tax coordinated economies allocate a substantial share of national income to welfare provision. Germany's welfare state is comprehensive and highly effective, supported by strong labour market institutions, high employment rates, and consistent public investment. The system's structure, built around contributory insurance schemes, ensures broad coverage and robust social protection. Germany consistently achieves low levels of inequality and poverty relative to EU averages, demonstrating the redistributive effectiveness of its welfare model. Social mobility is supported by high-quality education, vocational training, and housing assistance, further reinforcing social cohesion.

Italy's welfare performance is more uneven. Although Italy allocates a similarly high share of GDP to social protection, much of this expenditure is concentrated in pensions, reflecting demographic pressures and long-standing institutional arrangements. This leaves fewer resources available for family support, unemployment assistance, and active labour market policies. As a result, Italy struggles to reduce inequality and social exclusion to the same extent as Germany. Regional disparities further exacerbate these challenges: northern regions exhibit welfare outcomes closer to coordinated European models, while southern regions face persistent unemployment, limited service provision, and higher poverty rates. Italy illustrates how the high-tax coordinated model requires not only revenue but also institutional efficiency and balanced expenditure to achieve equitable outcomes.

Competitive-tax economies adopt a different approach. In Ireland, welfare performance is shaped by a dual economy characterised by high-skilled employment in multinational sectors and more precarious conditions in domestic industries. Ireland's welfare state is smaller than those of coordinated economies and relies more heavily on targeted benefits and means-tested programs. Despite strong employment growth, the country faces elevated levels of market inequality, high housing costs, and gaps in healthcare accessibility. Government spending has increased in recent years to address these issues, but the underlying reliance on a narrow tax base, dominated by multinational profits, creates vulnerabilities that complicate long-term welfare planning.

The Netherlands provides a more balanced expression of welfare within the competitive-tax model. Its welfare system is moderate in size but highly effective, supported by strong institutions, universal health coverage delivered through a regulated insurance model, and advanced labour market activation policies. Dutch social protection achieves relatively low levels of inequality and high employment rates, demonstrating that competitive-tax systems can deliver strong social outcomes when supported by high institutional capacity. However, rising healthcare costs and demographic shifts, similar to those affecting other European countries, pose long-term challenges for fiscal sustainability.

A critical comparison across the four countries reveals three central insights:

1. Welfare performance reflects institutional quality more than tax levels alone.

Germany and the Netherlands, both high-capacity states, achieve strong social outcomes despite operating under different fiscal philosophies. Italy and Ireland display weaker outcomes in specific areas due to structural and institutional constraints.

2. High-tax coordinated systems reduce inequality more effectively. Redistributive mechanisms in Italy and especially Germany significantly narrow income disparities. In competitive-tax economies, initial inequality before taxes and transfers is higher, and post-transfer inequality remains less compressed, particularly in Ireland.

3. Competitive-tax models balance social protection with labour market flexibility.
Ireland and the Netherlands maintain high employment rates but confront challenges such as housing pressures, dual labour markets, and constrained welfare capacity.

Overall, the comparison shows that **fiscal models shape social outcomes but do not fully determine them**. Institutional capacity, labour market structure, and demographic pressures play equally important roles. Nonetheless, the structural differences between coordinated high-tax and competitive low-tax models create divergent trajectories for social cohesion, inequality mitigation, and welfare sustainability, reinforcing the broader pattern of Europe's two fiscal speeds.

4.4.4 Institutional and Governance Comparison

Institutional strength and governance quality are central determinants of how effectively countries can implement their fiscal strategies, manage public resources, and respond to economic shocks. Comparing Italy and Germany (high-tax coordinated economies) with Ireland and the Netherlands (competitive-tax economies) reveals a structural divide that profoundly shapes the functioning and long-term sustainability of each model. Institutions mediate the relationship between taxation, public spending, competitiveness, and social outcomes, and therefore play a decisive role in defining the two fiscal speeds of Europe.

Germany displays one of the strongest institutional frameworks in the European Union. Its governance model is characterised by administrative efficiency, regulatory stability, and predictable policymaking. These features support high levels of public spending and ensure that revenue from taxation is converted into effective services and long-term investment. Germany's federal structure, combined with cooperative arrangements between the state, employers, and labour unions, enhances coordination and fosters a stable environment for firms and workers. This strong institutional capacity mitigates the potential drawbacks of high taxation and underpins the country's long-term competitiveness.

Italy presents a much more complex institutional landscape. Although its legal and administrative traditions are well established, the country faces significant challenges related to bureaucratic fragmentation, inconsistencies in policy implementation, and regional disparities. Administrative complexity and slower judicial processes raise transaction costs for firms and reduce the country's ability to efficiently allocate public resources. These institutional weaknesses limit the effectiveness of Italy's high-tax coordinated model, as high revenues alone are insufficient to produce the outcomes observed in countries with stronger governance capacity. Italy's constraints illustrate the importance of institutional coherence in sustaining coordinated fiscal models, particularly in areas such as public investment, innovation policy, and labour market governance.

Ireland and the Netherlands demonstrate how strong institutional environments can support competitive-tax strategies. Both countries rank highly in measures of regulatory quality, rule of law, and government effectiveness. Their public administrations are characterised by transparency, professionalism, and efficient service delivery, factors that are crucial for attracting multinational enterprises and maintaining investor confidence. Regulatory frameworks in both countries prioritise clarity and stability, enabling firms to operate with predictable tax and administrative obligations. This institutional strength amplifies the economic benefits of competitive-tax policies and helps mitigate potential vulnerabilities associated with global financial integration.

The Netherlands, in particular, exhibits a high degree of administrative coordination and sectoral governance, allowing it to manage a complex economic structure that includes financial hubs, logistics networks, and knowledge-intensive industries. Its institutional capacity ensures effective oversight of competitive tax instruments, such as advance tax rulings, while complying with evolving EU requirements. Ireland's institutions also play a critical role in sustaining the country's development model by providing a stable and efficient environment for multinational enterprises. However, Ireland faces different governance pressures due to its narrower tax base and higher dependence on multinational profits, requiring agile policymaking and careful risk management.

Across all four countries, **EU governance and compliance** represent an additional layer of institutional complexity. High-tax economies such as Italy often face more stringent scrutiny regarding fiscal rules and budgetary discipline, whereas competitive-tax economies face increased oversight related to tax fairness, state aid, and anti-avoidance regulations. Germany and the Netherlands generally navigate EU compliance with ease due to their strong institutions, whereas Italy and Ireland encounter challenges linked respectively to structural deficits and tax competition pressures.

The comparative analysis of institutional and governance characteristics leads to three key insights:

1. Institutional capacity determines the effectiveness of fiscal models. High-tax systems require strong administrative and regulatory institutions to translate public revenues into effective outcomes. Germany demonstrates this clearly, while Italy's institutional weaknesses limit its performance.

2. Competitive-tax models rely on regulatory clarity and predictability. Ireland and the Netherlands succeed because firms value not only low or optimised taxation but also efficient institutions and consistent policymaking.

3. Governance differences reinforce Europe's two fiscal speeds. Even within a unified institutional framework like the EU, national governance quality significantly shapes fiscal outcomes, competitiveness, and resilience.

Overall, the governance comparison highlights that Europe's fiscal divergence is rooted not only in taxation but in the institutional capacities that sustain distinct economic models. Governance quality acts as the anchor that either strengthens or undermines the long-term viability of each fiscal strategy, contributing decisively to Europe's persistent two-speed trajectory.

4.4.5 Synthesis: Two Fiscal Speeds Inside the EU

The comparative analysis of Italy and Germany on one side, and Ireland and the Netherlands on the other, reveals a structural and persistent divide that shapes the fiscal, economic, and institutional landscape of the European Union. These differences do not simply reflect variations in taxation or spending levels; they embody two distinct philosophies of state intervention, competitiveness, and economic governance. Together, they form the foundation of what may be defined as **Europe's two fiscal speeds**.

High-tax coordinated economies, represented by Italy and Germany, rely on comprehensive tax systems, extensive social protection, and long-term investment in welfare and public services. Their fiscal structure is built on the assumption that social cohesion, institutional stability, and coordinated labour markets are essential to economic resilience and inclusive growth. Germany demonstrates the strength of this model when supported by robust institutions, while Italy illustrates its vulnerability when structural weaknesses limit the effective use of public resources. The coordinated approach produces stability and strong redistribution, but its success depends heavily on institutional capacity, productivity dynamics, and demographic conditions.

Competitive-tax economies, represented by Ireland and the Netherlands, adopt a different developmental logic. Their model prioritises fiscal agility, attractive corporate tax regimes, and integration into global markets. These economies leverage multinational enterprises, strategic tax instruments, and regulatory efficiency to generate growth, employment, and innovation. While the model delivers dynamism and high competitiveness, it is also exposed to external risks, international tax reforms, and the volatility associated with global capital flows. Ireland demonstrates the power of this strategy, along with its fragility, while the Netherlands represents a more diversified and institutionally anchored version of the same approach.

The juxtaposition of these two models highlights three core structural divergences within the EU:

1.Divergent fiscal capacities and revenue structures. High-tax systems rely on broad, stable tax bases and large welfare commitments; competitive-tax systems rely on targeted fiscal incentives and external capital inflows. These differences shape each model's ability to respond to crises, finance public services, and sustain long-term investment.

2. Divergent competitiveness strategies. Coordinated economies anchor competitiveness in industrial ecosystems, institutional coordination, and innovation capacity. Competitive-tax economies rely on fiscal attractiveness, multinational networks, and global value chain integration. These paths produce asymmetrical outcomes in productivity, labour markets, and economic resilience.

3. Divergent institutional underpinnings. Institutional quality amplifies or constrains each model. Germany and the Netherlands demonstrate how strong institutions enhance the effectiveness of both fiscal strategies; Italy and Ireland show how structural or external vulnerabilities interact with their respective systems.

Together, these divergences generate **persistent asymmetries** inside the Single Market. Capital flows, investment decisions, labour mobility, taxation bases, and bargaining power increasingly align with the two contrasting fiscal logics. Competitive-tax economies attract high-value activities and multinational profits, while coordinated economies bear a larger share of welfare obligations and institutional responsibilities. These dynamics contribute to a widening gap in economic performance, fiscal flexibility, and political leverage across the Union.

The synthesis demonstrates that Europe's "two fiscal speeds" are not transient anomalies but structural realities embedded in national choices, institutional architectures, and global economic integration. Understanding this divergence is essential for analysing the challenges of fiscal harmonisation, fair competition, and regulatory coherence within the EU. This comparative assessment sets the stage for Chapter 5, which explores the weaknesses of the European regulatory framework and the tensions that arise when fundamentally different fiscal models coexist within a unified economic and institutional space.

4.5 Discussion: Implications for EU Fiscal Integration

The coexistence of high-tax coordinated economies and competitive-tax economies within the European Union creates structural tensions that complicate efforts toward fiscal integration, regulatory harmonization, and fair competition. The analysis developed in this chapter shows that these models are not simply different fiscal strategies, they are distinct economic philosophies embedded in national institutions, competitiveness dynamics, and political cultures. As a result, the EU faces the challenge of governing a Single Market in which member states operate under fundamentally different fiscal logics.

High-tax coordinated economies demand stronger EU-level regulation to prevent tax erosion, ensure fair competition, and reinforce fiscal stability. Their welfare commitments and public investment strategies rely on broad, stable domestic tax bases, bases that can be weakened by aggressive tax competition and profit-shifting behaviors facilitated by low-tax jurisdictions. For these countries, deeper fiscal cooperation is essential to preserving the sustainability of their economic models and preventing a race to the bottom.

Competitive-tax economies, however, view fiscal autonomy as a core element of their development strategies. Ireland and the Netherlands leverage tax flexibility to attract foreign investment, integrate into global value chains, and maintain competitive advantages. Strong EU harmonization, particularly in the area of corporate taxation, could erode critical pillars of their economic positioning. As such, these countries often support coordination that enhances transparency but resist measures that restrict their fiscal instruments.

These opposing pressures create **an integration paradox**:

- The EU needs more fiscal coherence to safeguard the integrity of the Single Market.
- But the diversity of national fiscal models makes deep harmonization politically and economically contentious.

To better contextualize this tension, the table below provides a brief chronological overview of major EU steps toward fiscal coordination and how they intersect with the divergent interests of member states.

Table 4.5 — Key Milestones in EU Fiscal Integration and Their Implications for Divergent Fiscal Models (1992–2023)

Year	Initiative / Event	Relevance for Two Fiscal Models
1992	Maastricht Treaty	Introduces fiscal rules (deficit/debt), reinforcing coordinated discipline; little impact on tax competition.
1997	Stability and Growth Pact	Strengthens budgetary oversight, supported by high-tax states; low-tax states largely unaffected.
2011–2013	Six-Pack, Two-Pack, Fiscal Compact	Deepens surveillance; coordinated economies push for strict rules, competitive-tax states focus more on flexibility.
2015–2016	Anti-Tax Avoidance Package / State Aid Cases	Targets aggressive tax planning; strong resistance from low-tax states as multinationals come under scrutiny.
2021–2023	Minimum Global Tax (OECD Pillar Two)	Major turning point; reduces tax competition margins; affects Ireland and Netherlands more than coordinated economies.
2020–2026	Recovery and Resilience Facility	Moves the EU toward shared fiscal capacities; coordinated states support deeper integration, competitive-tax states remain cautious.

Source: *Author's elaboration based on the Treaty on European Union (1992), Stability and Growth Pact (1997), Six-Pack and Two-Pack legislation (2011–2013), Treaty on Stability, Coordination and Governance (Fiscal Compact), European Commission Anti-Tax Avoidance Package (2016), OECD/G20 Inclusive Framework on BEPS (Pillar Two, 2021), and Regulation (EU) 2021/241 establishing the Recovery and Resilience Facility.*

These milestones illustrate the asymmetric impact of EU fiscal initiatives. Measures related to **budgetary discipline** (Maastricht, SGP, Fiscal Compact) matter more for high-debt coordinated economies such as Italy. Measures targeting **corporate taxation and profit shifting** (state aid cases, anti-avoidance packages, global minimum tax) affect competitive-tax economies more directly, challenging elements of their growth strategies.

The cumulative effect is a widening political and economic divide:

- **Coordinated economies** seek stronger EU-level regulation to compensate for the erosion of national fiscal capacity.
- **Competitive-tax economies** defend tax autonomy as essential to maintaining their competitive advantages.

This divergence limits the feasibility of deep fiscal integration and explains why progress has been incremental and strongly conditioned by external shocks (e.g., financial crisis, pandemic, global tax reforms). The EU operates in an environment where the integrity of the Single Market depends increasingly on resolving tensions between these two models.

The following sections explore these dynamics in greater detail, beginning with the challenges that fiscal divergence poses for harmonization and fair competition within the Union.

4.5.1 Challenges for Harmonization and Fair Competition

The coexistence of divergent fiscal models within the European Union creates structural challenges for harmonization and fair competition. High-tax coordinated economies depend on broad and stable tax bases to finance welfare systems, public services, and long-term investment. Competitive-tax economies, by contrast, rely on fiscal agility and strategic tax regimes to attract investment, integrate into global value chains, and compensate for their smaller domestic markets. These conflicting priorities have made it difficult for the EU to adopt common standards capable of reconciling national autonomy with the need for market-wide fairness.

One of the central challenges concerns **tax-base erosion and profit shifting**. Competitive-tax economies such as Ireland and the Netherlands attract multinational enterprises through favourable tax conditions, generating substantial revenue and economic activity. While this strategy benefits these countries, it also enables multinationals to shift profits away from higher-tax jurisdictions, reducing tax bases in coordinated economies like Italy and Germany. This creates an uneven playing field in which coordinated economies bear a heavier share of the fiscal burden required to support welfare and public investment, while competitive economies benefit from capital inflows and lower tax costs.

A second challenge lies in the **asymmetry of incentives**. High-tax coordinated economies advocate for stronger harmonization to prevent harmful tax competition and protect their revenue bases. Competitive-tax economies, however, perceive tax autonomy as a cornerstone of their economic strategy. As a result, they tend to resist measures that could constrain their competitive advantages, especially in areas such as corporate taxation, tax rulings, and the treatment of intellectual property. These divergent interests frequently lead to political gridlock, slowing progress on EU-level reforms such as the Common Consolidated Corporate Tax Base (CCCTB) or proposals for minimum corporate taxation prior to the OECD global agreement.

The issue of **regulatory fragmentation** further complicates harmonization. While EU competition law and state aid rules impose certain constraints on national policies, they do not fully regulate tax competition. As a result, member states retain broad discretion in designing their tax systems, leading to regulatory inconsistencies that multinationals can exploit. Competitive-tax economies use this flexibility to establish predictable and business-friendly frameworks, while high-tax economies face pressure to maintain revenue capacity and uphold welfare commitments. This divergence undermines the principle of fair competition within the Single Market, allowing differences in taxation rather than differences in productivity or innovation to shape corporate location decisions.

Moreover, harmonization efforts face the structural challenge of **institutional heterogeneity**. Countries with strong administrative capacity, such as Germany and the Netherlands, can effectively implement and enforce complex tax rules, while others face difficulties due to bureaucratic fragmentation or institutional weaknesses. This uneven capacity limits the effectiveness of EU-wide regulations, as the impact of harmonization is mediated by national implementation processes. Coordinated economies rely heavily on consistent governance across member states to ensure fair competition, while competitive-tax economies leverage their strong institutions to maximize the benefits of flexible regulatory environments.

Finally, the introduction of the **global minimum tax (Pillar Two)** represents a major turning point, but also reveals persistent divides. While coordinated economies strongly support this reform as a step toward reducing harmful tax competition, competitive-tax economies face potential constraints on their traditional strategies. Ireland, for example, must adapt its longstanding 12.5% corporate tax rate, while the Netherlands must adjust aspects of its ruling system and holding company regimes. The implementation of these reforms has therefore required delicate political negotiation and underscores the difficulty of achieving harmonization when national fiscal models diverge so sharply.

Overall, the challenges for harmonization and fair competition stem from structural differences in fiscal philosophy, institutional capacity, and economic strategy. As long as the EU continues to host both high-tax coordinated and competitive-tax economies, progress toward deeper fiscal integration will remain incremental and contested. These tensions highlight the inherent difficulty of governing a shared economic space with fundamentally different national fiscal models—a reality that reinforces Europe's two-speed dynamic.

4.5.2 How Divergent Models Shape EU Policy and Power Dynamics

The coexistence of high-tax coordinated economies and competitive-tax economies within the European Union produces not only economic asymmetries but also significant **shifts in political influence and policy dynamics**. Fiscal models are inherently tied to national interests, institutional cultures, and economic structures; as a result, they shape how member states negotiate, align, and contest policy initiatives within the EU. The divergence between coordinated and competitive-tax systems generates competing visions of integration, redistributive mechanisms, and regulatory authority, visions that help to explain the persistent tensions within the Union and the slow pace of fiscal convergence.

High-tax coordinated economies, such as Italy and Germany, generally advocate for deeper fiscal integration, stronger oversight of corporate taxation, and tighter enforcement of EU-wide rules aimed at safeguarding fair competition. For these countries, aggressive tax competition erodes public revenues needed to sustain welfare systems and undermines the fiscal stability required by the EU's own governance frameworks. Consequently, coordinated economies tend to form alliances in favour of strengthening anti-tax avoidance measures, supporting harmonized tax bases, and enhancing budgetary supervision. Their political priorities reflect the critical role that stable domestic revenues play in financing expansive welfare and redistributive systems.

Competitive-tax economies, by contrast, derive strategic advantages from fiscal autonomy and the ability to design tax regimes tailored to their developmental models. Ireland and the Netherlands, for example, use favourable corporate tax systems to attract foreign direct investment, integrate into global markets, and sustain high levels of employment. As a result, they often resist EU initiatives perceived as threats to their competitive positioning, particularly reforms aimed at limiting fiscal flexibility or restricting tax rulings and preferential regimes. While these countries support measures that enhance transparency and combat abusive tax practices, they are more cautious toward structural reforms that could diminish their capacity to differentiate themselves within the Single Market.

These divergent preferences shape the **balance of power within EU decision-making**. High-tax economies possess demographic and economic weight, particularly Germany, which acts as a stabilizing anchor within monetary and fiscal governance. However, competitive-tax economies wield disproportionate influence in areas requiring unanimity, such as taxation. Their ability to block or delay initiatives creates a political environment in which progress toward harmonized corporate taxation remains slow and highly negotiated. This dynamic demonstrates how institutional rules interact with national fiscal models to shape policy trajectories.

Another important dimension concerns the **geography of economic influence** within the EU. Competitive-tax economies attract large concentrations of multinational activity, profit booking, and high-value corporate functions. This inflow of capital strengthens their economic visibility and bargaining power within policy debates, even when they represent smaller shares of the EU population or GDP. Ireland, for example, has become a central actor in discussions on global tax reform due to its strategic position within multinational corporate networks. The Netherlands similarly exerts influence as a major hub for financial flows and international business holdings.

Conversely, high-tax coordinated economies often emphasize the need for **solidarity and risk-sharing mechanisms**, particularly within the euro area. Their advocacy for tools such as the Recovery and Resilience Facility, the European Stability Mechanism, or deeper fiscal coordination reflects the structural requirements of their economic models. Italy, for instance, pushes for greater EU-level investment and flexibility in fiscal rules to compensate for domestic structural constraints. Germany, while supportive of stability-oriented integration, navigates between maintaining fiscal discipline and acknowledging the need for collective responses to systemic shocks.

The result is an EU political system characterized by **competing coalitions** and shifting alliances. High-tax economies align on issues of coordination and stability; competitive-tax economies align on issues of fiscal autonomy and market liberalization. These coalitions are not fixed, but they create predictable patterns that shape legislative outcomes, negotiation strategies, and policy reforms.

Ultimately, divergent fiscal models produce **asymmetrical political power** that reinforces Europe’s two-speed dynamic. Competitive-tax economies exert significant influence in areas of taxation and corporate regulation, while coordinated economies dominate debates on fiscal rules, crisis management, and welfare-related policies. The EU must therefore navigate a multidimensional political landscape where efforts toward integration must balance fundamentally different fiscal philosophies and national interests.

4.5.3 Long-Term Risks of Persistent Fiscal Asymmetry

The persistence of divergent fiscal models within the European Union creates long-term structural risks that extend far beyond taxation. These risks concern not only economic performance but also institutional cohesion, political legitimacy, and the ability of the EU to act collectively in times of crisis. As high-tax coordinated economies and competitive-tax economies continue to evolve along different trajectories, the asymmetry between them threatens to deepen, challenging the foundations of the Single Market and the broader project of European integration.

A first major risk concerns **the erosion of fiscal capacity in high-tax coordinated economies**. When multinational enterprises shift profits toward competitive-tax jurisdictions, coordinated economies experience a gradual reduction in their tax bases. This undermines their ability to fund welfare systems, invest in long-term development, and meet EU fiscal targets. Over time, the imbalance between expenditure commitments and shrinking revenues can generate structural deficits, limit public investment, and weaken resilience. Italy illustrates how fragile this equilibrium can be when institutional weaknesses interact with external fiscal pressures.

A second risk lies in **the increasing concentration of economic activity in competitive-tax economies**. As Ireland and the Netherlands continue to attract multinational headquarters, financial operations, and high-value services, economic geography within the EU becomes more polarized. This concentration reinforces regional disparities, exacerbating the divide between more dynamic northern hubs and slower-growing southern or eastern regions. These imbalances affect labour mobility, capital flows, and investment patterns, creating a form of economic gravitational pull that is difficult to reverse without coordinated policy action.

A third risk concerns **systemic vulnerability**. Competitive-tax economies benefit from global integration, but this same integration exposes them to external shocks, including changes in international tax rules, global minimum tax requirements, and evolving corporate strategies. If multinational enterprises adjust their structures or relocate activities in response to global reforms, countries like Ireland could face sudden revenue losses or declines in employment in key sectors. Such vulnerabilities have implications not only for national economies but also for the broader EU, given the interconnected nature of supply chains and corporate networks.

Persistent fiscal asymmetry also risks **undermining political cohesion within the EU**. Divergent fiscal models contribute to conflicting policy preferences, making it difficult to build consensus on critical issues such as corporate tax harmonization, fiscal rules reform, or the distribution of investment funds. This tension can lead to fragmentation in EU governance, with member states forming coalitions based on fiscal interests rather than broader strategic objectives. Over time, this dynamic weakens the EU's ability to respond collectively to economic crises, climate transition needs, and geopolitical challenges.

Another long-term risk concerns **legitimacy and public perception**. If citizens perceive that the fiscal benefits of EU membership accrue disproportionately to certain member states, particularly those able to attract multinational profits through competitive tax regimes, the legitimacy of the Single Market may be called into question. This perception can fuel Euroscepticism, particularly in high-tax countries where taxpayers may feel that their financial contributions support a system that allows profit-shifting to low-tax jurisdictions. Likewise, competitive-tax economies may resist deeper integration if they fear losing the strategic advantages that underpin their economic models.

Finally, persistent asymmetry threatens the EU's **strategic autonomy**. A fragmented fiscal landscape limits the Union's ability to mobilize common resources, coordinate industrial policy, and respond to international tax reforms. If fiscal divergence continues to widen, the EU may struggle to develop cohesive strategies in areas such as digital taxation, green investment, and the global minimum corporate tax. This limits the Union's external influence and its capacity to shape global economic governance.

In sum, the long-term risks associated with fiscal asymmetry highlight the importance of addressing structural divergences between EU member states. Without mechanisms to reconcile the interests of high-tax coordinated economies and competitive-tax economies, Europe's two fiscal speeds may become entrenched, undermining both economic integration and political unity. This provides the rationale for a deeper analysis, developed in Chapter 5, of the regulatory weaknesses that allow such asymmetry to persist, and the reforms needed to strengthen the EU's fiscal architecture.

4.6 Concluding Remarks

The comparative analysis conducted in Chapter 4 demonstrates that the European Union hosts two distinct fiscal models, high-tax coordinated economies and competitive-tax economies, whose structural features, institutional capacities, and developmental trajectories diverge in fundamental ways. These models coexist within the same regulatory and economic framework but operate according to different logics. High-tax systems rely on extensive public sectors, broad tax bases, and long-term investment in welfare and institutional stability. Competitive tax systems, by contrast, prioritise fiscal agility, international integration, and the attraction of multinational enterprises. Each model embodies specific strengths, weaknesses, and strategic dependencies.

The chapter showed that these differences manifest across multiple dimensions: fiscal structure, economic performance, welfare provision, innovation capacity, and governance quality. Germany and the Netherlands illustrate the importance of strong institutions in enabling both models to function effectively, while Italy and Ireland reveal the vulnerabilities that emerge when structural weaknesses intersect with fiscal pressures. The results demonstrate that fiscal divergence within the EU is not merely the outcome of policy choices but reflects deeply embedded institutional and economic characteristics.

The findings also highlight the impact of fiscal divergence on the broader EU architecture. Persistent asymmetries shape capital flows, labour mobility, investment patterns, and regulatory preferences. They also influence political alignments and negotiation dynamics at the EU level, where member states advocate for integration paths consistent with their national fiscal models. This divergence complicates efforts to harmonise tax rules, reinforce fair competition, and consolidate the Union's fiscal governance framework.

At the same time, the analysis makes clear that both models contribute to the complexity and dynamism of the European economy. High-tax coordinated economies provide stability, social cohesion, and long-term investment capacity. Competitive-tax economies drive innovation, attract global capital, and support economic dynamism. Yet the coexistence of these models also generates tensions that, if left unaddressed, could undermine the coherence and resilience of the Single Market.

These conclusions set the stage for Chapter 5, which examines the **weaknesses of European regulation** that allow fiscal divergence to persist and, in some cases, intensify. Understanding the regulatory gaps, institutional constraints, and political obstacles at the EU level is essential for assessing whether greater fiscal coordination is feasible, and, if so, what form it might take. The next chapter therefore shifts the focus from national fiscal models to the supranational governance mechanisms that shape their interaction, providing insight into the limits and potential of EU fiscal integration.

Chapter 5: Weaknesses of European Regulation

5.1 Introduction: Regulation and the Limits of Integration

The European Union represents one of the most advanced models of economic integration worldwide. The establishment of the Single Market, the centralisation of competition policy, and, within the euro area, the creation of a common monetary authority reflect a high degree of supranational coordination. Yet this integration remains structurally incomplete in the fiscal domain. The persistence of divergent tax regimes and the coexistence of high-tax coordinated systems and competitive-tax models reveal a regulatory architecture marked by asymmetry rather than uniformity.

Unlike trade or competition policy, fiscal policy has not been transferred to the supranational level. Member States retain authority over tax rates, tax bases, exemptions, and incentives. This allocation of competences, grounded in the Treaties and reinforced by the unanimity requirement in tax matters, creates a structural tension between economic integration and national sovereignty. As a result, efforts to harmonise corporate taxation or restrict preferential regimes frequently encounter institutional deadlock.

This constitutional design has tangible economic consequences. Competitive-tax economies leverage fiscal autonomy to attract multinational enterprises and integrate strategically into global value chains. High-tax coordinated systems, by contrast, rely on stable and substantial tax revenues to sustain welfare structures and long-term public investment. The divergence of these models generates conflicting policy preferences, complicating attempts to construct a coherent fiscal framework at Union level.

The EU has responded with incremental regulatory instruments, including anti-avoidance directives, strengthened administrative cooperation, and intensified State aid enforcement. These initiatives enhance transparency and limit certain distortive practices, but they operate within constrained legal competences. They address specific manifestations of tax competition without fundamentally altering its structural foundations.

Institutional asymmetries further weaken regulatory coherence. Member States differ significantly in administrative capacity, enforcement culture, and institutional stability. Such disparities affect the uniform application of EU rules and contribute to uneven implementation across the Union. Consequently, fiscal governance remains fragmented despite formal coordination mechanisms.

Regulatory weaknesses in the fiscal sphere therefore extend beyond technical limitations. They influence corporate behaviour, shape investment decisions, and reinforce structural economic imbalances among Member States. The limits of integration are not accidental; they reflect the constitutional settlement underpinning the Union. Understanding these limits is essential for assessing both the persistence of fiscal divergence and the prospects for deeper integration.

The following sections analyse in detail the legal and institutional constraints that define these regulatory boundaries.

5.2 Legal and Institutional Constraints

The European Union's limited capacity to regulate national fiscal systems is rooted in the constitutional allocation of competences established by the Treaties. Under the principle of conferral enshrined in **Article 5(2) TEU**, the Union may act only within the limits of competences explicitly attributed to it. Taxation, however, has not been transferred as a general Union competence and remains primarily within the sovereignty of the Member States. This deliberate constitutional choice sets a structural boundary to fiscal integration.

Harmonisation in tax matters is possible only under specific legal bases and subject to strict procedural constraints. **Article 113 TFEU** permits harmonisation of indirect taxation insofar as necessary for the functioning of the internal market, while **Article 115 TFEU** allows the approximation of national laws affecting the internal market, including aspects of direct taxation. Crucially, both provisions require unanimity in the Council. This unanimity rule grants each Member State veto power, transforming fiscal reform into a negotiation driven by national interest alignment rather than supranational economic logic.

Attempts to rely on broader internal market competences, particularly **Article 114 TFEU**, are legally constrained. While Article 114 provides a general legal basis for harmonisation measures necessary to ensure the establishment and functioning of the internal market, it cannot be used to circumvent the specific unanimity requirements governing taxation. The Court of Justice has consistently interpreted legal bases in light of their primary objective, thereby limiting the possibility of expanding fiscal harmonisation through regulatory reinterpretation.

Institutional fragmentation reinforces these constraints. The European Commission may initiate proposals and enforce State aid rules under **Article 107 TFEU**, yet it lacks the authority to impose uniform tax structures. The European Parliament has only consultative power in many fiscal matters, and the Court of Justice operates reactively, adjudicating disputes rather than designing policy. As a result, the EU's fiscal governance relies on indirect mechanisms, transparency rules, anti-avoidance directives, and competition law enforcement, rather than direct centralisation of taxing power.

These structural features are compounded by political and economic heterogeneity across Member States. Divergent fiscal models reflect distinct social contracts, economic strategies, and administrative capacities. The Treaties preserve this diversity by design, prioritising national sovereignty in taxation over uniformity.

In this light, the persistence of fiscal divergence within the European Union is not merely the result of political disagreement or incomplete policy coordination. Rather, it is a structural consequence of the Treaties' constitutional architecture. The Union's legal order enables economic integration while deliberately limiting fiscal centralisation, thereby institutionalising the conditions under which Europe's "two fiscal speeds" can endure.

5.3 Regulatory Ineffectiveness and Loopholes

Even where the European Union possesses formal regulatory instruments, including anti-avoidance directives, transparency obligations, and State aid enforcement under **Article 107 TFEU**, their effectiveness remains structurally constrained. Regulatory weakness does not derive solely from technical gaps in legal drafting. Rather, it reflects the interaction between limited supranational competences, national discretion, and the complexity of multinational corporate taxation.

A first source of ineffectiveness lies in the fragmented transposition of secondary legislation adopted under **Article 115 TFEU**. Directives such as ATAD I and II establish minimum standards but leave considerable room for national interpretation. Optional clauses, variable thresholds, and differentiated implementation create regulatory asymmetries across Member States. This flexibility enables regulatory arbitrage, allowing multinational enterprises to exploit inconsistencies in national transposition while formally remaining within the boundaries of EU law.

A second limitation concerns the reactive nature of enforcement. State aid investigations address selective advantages on a case-by-case basis but do not fundamentally reshape national tax systems. Enforcement therefore operates ex post and episodically rather than through systemic harmonisation. In the absence of legislative convergence, fiscal governance advances through administrative and judicial channels, producing incremental corrections rather than structural reform.

Regulatory gaps are further amplified by the opacity of multinational corporate structures. Profit-shifting mechanisms involving intangible assets, intra-group financing, and intellectual property transfers remain difficult to monitor despite improved information exchange. Administrative capacity varies significantly across Member States, leading to uneven enforcement of common rules. This disparity reinforces fiscal asymmetry and undermines uniform application within the internal market.

Special tax regimes illustrate an additional structural weakness. Patent boxes, notional interest deductions, and preferential holding regimes often comply formally with EU standards while preserving competitive advantages. Soft coordination mechanisms, such as the Code of Conduct Group on Business Taxation, lack binding force and therefore depend on political goodwill rather than enforceable obligations.

The interplay between national incentives and limited EU authority compounds these problems. The Commission may intervene only where measures distort competition within the meaning of **Article 107 TFEU**, leaving broader forms of tax competition outside its jurisdiction. Simultaneously, national governments may have limited incentives to scrutinise practices that attract investment and fiscal revenues. This dual constraint, restricted supranational power and selective domestic enforcement, sustains regulatory loopholes.

Finally, fiscal regulation operates within a global environment characterised by high capital mobility and flexible corporate networks. If international tax competition persists, EU measures that stop short of harmonising core tax bases and rates can mitigate distortions but cannot eliminate them.

Taken together, these dynamics reveal that regulatory ineffectiveness is not accidental but systemic. The persistence of loopholes, uneven implementation, and constrained legal competences reflects the broader constitutional structure of the Union. In this context, Europe's "two fiscal speeds" endure not despite regulation, but within the limits of a regulatory framework that remains structurally incomplete.

5.4 Political Economy of Non-Harmonization

Fiscal divergence within the European Union persists not only because of legal constraints, but because non-harmonisation is politically rational. Member States face asymmetric incentives shaped by national economic models, domestic political pressures, and distributional consequences. In this context, fiscal autonomy represents a strategic asset rather than a regulatory gap.

Competitive-tax economies benefit directly from maintaining control over corporate taxation. Preferential regimes and low effective rates attract multinational enterprises and sustain domestic growth coalitions. Given the unanimity requirement under **Article 115 TFEU**, these states possess both the incentive and the institutional capacity to block reforms that would reduce fiscal differentiation.

High-tax coordinated economies, by contrast, rely on stable tax bases to finance welfare systems and public investment. Although they bear greater costs from profit shifting, they do not form a cohesive bloc in favour of harmonisation. Divergent fiscal cultures and macroeconomic positions weaken collective action, limiting the prospects for transformative reform.

Domestic politics further entrench this equilibrium. Taxation is closely tied to sovereignty and national social contracts, making governments reluctant to transfer authority to the EU level. Moreover, any harmonisation would redistribute revenue and investment across Member States, creating clear winners and losers. These distributional effects reinforce resistance within a decision-making system governed by unanimity.

Institutional path dependence and global competitive pressures complete the picture. National tax systems are deeply embedded in administrative and economic structures, while capital mobility strengthens incentives to preserve flexibility. As long as these conditions persist, fiscal non-harmonisation remains a stable political equilibrium.

Europe’s “two fiscal speeds” therefore reflect not a temporary failure of coordination, but a structurally sustained outcome of political economy dynamics embedded within the Union’s constitutional framework.

5.5 Case Study: The Apple–Ireland Ruling and Its Implications

The Apple–Ireland case represents a defining moment in the evolution of EU fiscal governance. More than a dispute over tax rulings, it illustrates the judicialisation of fiscal regulation within a system that lacks direct legislative harmonisation. In the absence of EU competence to harmonise corporate taxation, the Commission relied on **Article 107 TFEU** (State aid) to challenge national tax practices. This strategic use of competition law reveals both the creativity and the limits of supranational intervention.

For decades, Ireland built its development model around fiscal autonomy, including a 12.5% corporate tax rate and favourable administrative practices. Tax rulings granted to Apple in 1991 and 2007 allowed profits generated across Europe to be allocated to entities with limited economic substance, resulting in extremely low effective taxation. In 2016, the Commission concluded that these arrangements constituted selective advantages incompatible with the internal market and ordered the recovery of €13 billion in unpaid taxes, the largest State aid decision in EU history.

The legal controversy that followed exposed a structural tension. Ireland and Apple argued that the Commission was effectively redefining national tax law under the guise of State aid control. The dispute therefore centred not only on selectivity, but on institutional boundaries: can competition law function as a substitute for fiscal harmonisation? In 2020, the General Court annulled the Commission's decision, emphasising the high evidentiary burden required to prove selective advantage in complex multinational tax structures. The ruling demonstrated the limits of using State aid as an indirect regulatory instrument.

The case exemplifies a broader governance shift. In the absence of legislative convergence under **Articles 113 and 115 TFEU**, fiscal integration advances through judicial and administrative channels. This “judicialisation” produces high-profile interventions but lacks systemic coherence. It corrects individual cases without addressing the structural incentives that enable aggressive tax planning.

At the same time, the Apple ruling intensified political debate on fiscal fairness and contributed to momentum for international reform, including the OECD-led global minimum tax initiative. Its impact therefore extended beyond the EU legal order, reinforcing the perception that unilateral enforcement is insufficient in a globally mobile tax environment.

Ultimately, the Apple–Ireland case highlights the structural incompleteness of EU fiscal governance. It reveals a Union capable of challenging extreme distortions through competition law, yet constrained by constitutional limits that prevent comprehensive harmonisation. In this sense, the case does not resolve fiscal divergence; it illustrates the boundaries within which Europe’s “two fiscal speeds” continue to operate.

5.6 Prospects for Reform and the Path Ahead

The persistence of fiscal divergence, combined with the constitutional limits embedded in the Treaties, places EU fiscal governance at a crossroads. Reform is no longer a purely technical matter; it is a question of political will and institutional recalibration. The challenge is not simply to improve coordination, but to address the structural asymmetry between deep market integration and decentralised fiscal authority.

Incremental progress has already occurred. Enhanced transparency, anti-avoidance directives adopted under **Article 115 TFEU**, and strengthened enforcement of **Article 107 TFEU** have reduced the most visible distortions of tax competition. Yet these instruments operate within a framework that preserves unanimity and national sovereignty. They mitigate symptoms without transforming underlying incentives.

More ambitious reform would require revisiting decision-making structures and expanding common fiscal tools. Moving beyond unanimity in carefully defined areas linked to the integrity of the internal market, or strengthening EU-level fiscal capacities under **Article 311 TFEU**, would mark a qualitative shift. Similarly, initiatives such as BEFIT and the implementation of the global minimum tax signal an emerging recognition that fragmented national regimes are increasingly incompatible with an integrated economic space.

At the same time, durable reform depends on political convergence. Competitive-tax economies must reassess the long-term sustainability of growth models built on fiscal differentiation, while coordinated economies must accept that integration requires flexibility and institutional adaptation. Without mutual accommodation, structural divergence will persist.

The future of EU fiscal governance therefore hinges on a fundamental choice: preserve a decentralised equilibrium that accommodates "two fiscal speeds," or pursue deeper integration capable of aligning fiscal authority with market unity. The Treaties have so far prioritised sovereignty over centralisation. Whether this balance can evolve will determine the trajectory of Europe's fiscal architecture in the decades ahead.

Chapter 6: Conclusion of the Thesis

6.1 Summary of Findings and Reflections

This thesis has argued that fiscal divergence within the European Union constitutes a structural outcome of its institutional design rather than a temporary imbalance. The coexistence of high-tax coordinated systems and competitive-tax models reflects enduring differences in economic structure, institutional capacity, and policy priorities across Member States. Fiscal policy, in this context, functions not only as a macroeconomic instrument but as an expression of distinct national development strategies.

The comparative analysis of Italy, Germany, Ireland, and the Netherlands has shown that coordinated high-tax systems rely on broad and stable revenue bases to sustain comprehensive welfare provision, industrial coordination, and long-term public investment. Competitive-tax systems, by contrast, employ corporate taxation strategically to attract multinational enterprises, integrate into global value chains, and stimulate investment-led growth. These models operate within the same Single Market but respond to different structural constraints and incentives. Their divergence is therefore systemic and embedded in institutional configurations rather than cyclical or episodic.

The EU governance framework reinforces this asymmetry. Monetary policy is centralised under the European Central Bank, while fiscal authority remains predominantly national. Surveillance mechanisms, fiscal rules, and State aid enforcement constrain extreme deviations but do not eliminate structural differences in tax design and expenditure composition. As a result, integration remains deeper in market regulation than in fiscal capacity.

Europe's "two fiscal speeds" thus emerge as a predictable consequence of a Union characterised by economic interdependence combined with decentralised fiscal sovereignty. Divergence persists because it is institutionally accommodated and politically sustained. Any movement toward greater convergence would therefore require not incremental coordination, but a redefinition of the balance between national fiscal autonomy and supranational authority.

This interpretation is consistent with the literature on European integration, which emphasises the persistence of fiscal decentralisation despite deep economic integration (Pisani-Ferry, 2014). Similarly, studies on tax competition highlight how the mobility of capital incentivises Member States to adopt differentiated fiscal strategies within a shared market framework (Devereux & Loretz, 2013).

6.2 The Persistence of Two Fiscal Speeds in Europe

The persistence of two fiscal speeds within the European Union reflects a structurally stable equilibrium rooted in institutional design, economic incentives, and political constraints. High-tax coordinated systems and competitive-tax regimes are not temporary deviations from a common trajectory; rather, they represent internally coherent models embedded in distinct economic structures and reinforced by path-dependent dynamics, whereby past policy choices and institutional structures constrain future adjustments and limit convergence (Pierson, 2000).

This distinction can also be interpreted through the lens of the "varieties of capitalism" approach, which identifies different institutional configurations shaping national economic models (Hall & Soskice, 2001). In this perspective, fiscal systems are embedded within broader institutional complementarities that reinforce divergence over time. Fiscal divergence, in this sense, is reproduced through institutional continuity rather than corrected through integration.

The EU Treaties formalise this coexistence. While economic integration has advanced through the deepening of market freedoms and the centralisation of monetary authority, taxation remains largely subject to unanimity and national sovereignty. This institutional asymmetry enables Member States to pursue differentiated fiscal strategies without breaching the legal architecture of the Union. Market integration thus proceeds alongside fiscal decentralisation, creating a framework in which heterogeneity is not eliminated but accommodated.

These models also generate self-reinforcing dynamics. Competitive-tax regimes consolidate their position through cumulative investment inflows, the development of multinational ecosystems, and reputational advantages in global capital markets. Coordinated high-tax systems, in contrast, reinforce institutional density, welfare legitimacy, and social stability through stable revenue structures and redistributive capacity. As these trajectories solidify, the political and economic costs of convergence increase. Adjustment would require either upward harmonisation of taxation or downward restructuring of welfare commitments, both of which entail substantial domestic trade-offs.

The endurance of two fiscal speeds therefore reflects the structural limits of integration in a union that is economically interdependent yet fiscally decentralised. It illustrates the constraints of advancing coordination without federation and the tensions inherent in sustaining competition within a heterogeneous economic area. Fiscal divergence persists not because integration has failed, but because the constitutional balance of the Union permits, and in certain respects incentivises, differentiated fiscal strategies.

6.3 Policy Recommendations and Outlook

Addressing fiscal divergence within the European Union requires reform that is both institutionally realistic and strategically coherent. Incremental improvements in transparency, anti-avoidance enforcement, and coordination are necessary but insufficient. Lasting progress depends on aligning fiscal governance more closely with the structural depth of economic integration.

A first priority concerns the harmonisation of corporate tax bases. Initiatives such as BEFIT represent a pragmatic pathway toward reducing profit-shifting and regulatory arbitrage while preserving national discretion over statutory rates. Convergence at the level of tax base definition would strengthen fairness and predictability within the Single Market without fully centralising fiscal sovereignty. These developments are also aligned with recent OECD initiatives on global minimum taxation, which aim to reduce harmful tax competition while preserving national fiscal autonomy (OECD, 2021). Complementary procedural reforms, including carefully circumscribed extensions of qualified majority voting in areas directly affecting market integrity, could enhance decision-making capacity while maintaining the constitutional balance between Member States.

A second pillar involves the gradual consolidation of EU-level fiscal instruments. The Recovery and Resilience Facility demonstrated that common borrowing and coordinated fiscal responses are feasible under conditions of systemic stress. Transforming this precedent into a modest but permanent fiscal capacity would better reflect the degree of economic interdependence within the Union and provide stabilisation mechanisms that reduce structural divergence.

Reform, however, cannot be purely technical. Competitive-tax economies must reassess the sustainability of differentiation in the context of global minimum taxation and heightened scrutiny of tax competition. High-tax coordinated economies, in turn, must modernise expenditure structures and improve administrative efficiency to ensure that revenue intensity translates into competitiveness and resilience. Convergence therefore requires reciprocal adaptation rather than unilateral adjustment.

Ultimately, the future of EU fiscal governance hinges on a constitutional choice. The Union may continue to operate within a decentralised equilibrium that accommodates differentiated fiscal models, accepting divergence as a structural feature of integration. Alternatively, it may progressively align fiscal authority with the depth of market and monetary integration, moving toward a more cohesive fiscal framework.

The trajectory of European integration will be determined by whether fiscal sovereignty remains the effective boundary of integration, or whether fiscal convergence becomes the next stage in its constitutional evolution. This choice is not merely technical; it defines the long-term architecture of the Union.

Overall, the findings of this thesis are consistent with the existing literature on fiscal divergence and European integration, which highlights the structural tension between economic integration and national fiscal sovereignty. Rather than converging toward a single model, the European Union continues to operate through the coexistence of differentiated fiscal systems, shaped by institutional, economic, and political factors.

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