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Taxing Europe

Two cases for a European power to tax

(with some comparative observations)

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Abstract

This paper considers the need for granting the European Union should a genuine power to tax. The argument is developed in several steps. First, it is shown that the granting of such a power to tax both *legally mandated* and *legally framed*. In stark contrast to classical international organisations, or for that purpose, to the Articles of Confederation, the Communities were expected to acquire full taxing and spending powers. Special attention is paid to the affirmation of the principle of social and economic cohesion as one of the fundamental principles of Community law. Second, it is argued that the development of a genuine power to tax of the Communities is *normatively desirable*. The positive normative properties of a European power to tax are unfolded in two reform cases: the modest and the ambitious cases of reform. The principle of *no public expenditure without taxation* is shown to require the financing of the present European budget through taxes. A proper determination of requirements of distributive justice in a complex political community is said to defend a larger European budget, aimed at the redistribution of economic resources *among* the citizens of the European Union. Third, the two cases of reform are *prudentially advisable*. Redistributive taxation is the price of European civilisation. It constitutes a basic precondition for the successful consolidation of the Union as a political community, and for the proper integration of new members once enlargement to the East is fully effective. A summary look to the American case further shown that the creation of supranational institutions tends to lead to the establishment of central powers to tax. Those tend to be reinforced once the question of distributive fairness in the allocation of public burdens becomes a central one in the political agenda (as it was the case in the United States from, at the very least, the turn of the XXth century). Fourth, the two cases of reforms are *feasible*. Legal, normative and prudential criteria point to the (partial) transfer to the Union of the power to tax savings income and corporate income.

Taxing Europe

Two cases for a European power to tax, with some comparative observations

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“the tax ought to be uniform; because the present constitution was particularly intended to affect individuals, and not states, except in particular cases specified”²

“Je préfère la réalité d’un souveraineté partagée à l’illusion d’une souveraineté nationale tournant à vide”³

Introduction

The granting of a power of the purse to the European Union has usually been regarded as a “radical” idea in European debates. This is rather awkward, given that the establishment of a European power to tax was inscribed in the founding Treaties of the European Communities.⁴ Different political and economic circumstances have prevented the realisation of the goal of financial autonomy of the Communities. But this state of affairs might not last long. The completion of Monetary Union, the signalling of a quasi-constitutional moment with the conveyance of a Convention on the future of the European Union, and the enlargement to the East are bringing about new pressures in favour of an effective European power to tax.

¹ Earlier versions of this paper were presented at the *Seminar on Constitutionalism in Europe*, organised by the Universidade Nova de Lisboa at the Summer School in Arrabida, at the SEFOS program in Bergen and at the First Pan-European Conference, ECPR, Bordeaux and at the ARENA Tuesday Seminar. Special thanks to Lars Blichner, Erik Oddvar Eriksen, Rune Ervik, John Erik Fossum, Sverker Gustavsson, the Ursula Hirschmann collective, Anders Mollanders, Lards Nold, Alexander Van Cappelen and Paulo Vila Maior for their helpful comments.

² Judge Iredell in *Hylton vs. US*, 3 U.S. 171 (1796) at 181.

³ See Dominique Strauss Kahn : *La flamme et la cendre*, (Paris, Grasset, 2001), p.201.

⁴ Articles 200 and 201 TEC and Article 172 TECAE.

There are already clear signs of change. In the run-up to the Belgian Presidency in the second half of 2001, Prime Minister Guy Verhofstadt recovered the old idea of granting the Union a more complete taxing power.⁵ The move was supported by Romano Prodi, President of the Commission,⁶ and by the German Chancellor Gerhard Schröder, and his Chancellor of the Exchequer, Hans Eichel.⁷ Despite considerable opposition,⁸ such a vision has a chance of being inscribed into the primary law of the Union within the present 'constitutional process'. The Communication from the Commission on the future of the European Union hints at the need of a genuine European power to tax.⁹ Several members of the Working Group on Economic Governance had reiterated the need for a European power to tax. This has been endorsed by one of the most influential Commissioners, Pascal Lamy.¹⁰ We might have reached a point at which it might simply not be feasible to further postpone a proper debate on the finances of the Union.

Leaving aside predictions, this paper puts forward two cases for the assignment of a taxing power to the institutions of the Union. Resort is made to critical normative arguments (that is, claims about what is *right*), but a good deal of the argument is based on a systematic and coherent interpretation of the Treaties (that is, to a good extent the argument is *immanent* to Community law as it stands). Therefore, the normative bent of the paper is framed by the existing authoritative legal provisions.

Section I contains a summary analysis of the evolution of the finances of the Union. The aim is to reconstruct the fiscal history of the Union with the help of two basic keys, namely, the units of contribution and of expenditure. A modest case of reform is put forward in Section II. On the basis of Articles TEC 200 and 201 (which mandate the establishment of a system of 'own resources'), and on the basis of the current structure and level of expenditure

⁵ See 'Premier calls for Euro-tax', *European Voice*, 1 Feb 2001; 'Verhofstadt: rebel with a cause', *European Voice*, 8 Feb 2001; 'Belgium raises prospect of EU tax to help finance budget costs', *Financial Times*, 4 May 2001.

⁶ See 'Prodi calls for a tax to finance the EU budget', *Financial Times*, 30 May 2001.

⁷ See 'Eichel issues call for a European tax', *Financial Times*, 15 Jun 2001 and 'Let EU levy taxes, urges Schröder', *The Guardian*, 13 April 2002.

⁸ See 'Eurotax call axed from EU blueprint', *European Voice*, 28 June 2001 and 'Reynders told not to talk up EU-wide tax', *European Voice*, 5 July 2001.

⁹ See 'Communication from the Commission, A project for the European Union', of 22.5.2002, COM (2002) 247 final, especially at p.25. See 'Romano Prodi, a desperate integrationist', *The Economist*, 25 May 2002.

¹⁰ Pascal Lamy: 'Convention: l'urgence', *Le Monde*, 12 September 2002.

of the Union, it is claimed that the Union should finance its budget by means of directly collected taxes; that is, by means of taxes paid directly to the Union, and not collected through national or regional contributions. The main arguments in support of the ‘modest case’ are three, namely (1) the democratic imperative of connecting taxation and public expenditure; (2) the need of financial transparency, which fosters debate on the costs and benefits stemming from each level of government; (3) and the stability of the tax system. The argument is further extended in Section III, which is devoted to the ‘ambitious’ case of reform. This case is legally grounded on Article TEC 158, which establishes social and economic cohesion as a goal that the Communities should strive for. According to the ‘ambitious case’, a European power of the purse should be instrumental to the achievement of a fairer distribution of economic resources among European citizens. On the basis of the present state of economic integration in Europe, it is argued that the legitimacy of the Union requires not only the ‘negative’ integration of the norms that create (literally) the common or single market, but also the positive integration of those norms which balance and compensate the risks stemming from the single market. Section IV aims at supporting the arguments made in the previous two sections with some lessons drawn from the American experience with federal taxation. Even a summary analysis of the American case points to the close connection between the establishment of a complex political community and the accrual of some power to tax to the central (supranational) level of government. It also seems to indicate that concern with the fairness of the tax burden further reinforces the power to tax of the the central level of government. Section V includes some notes on how it would be possible to implement the two reform proposals. A case is made for assigning the Union a non-exclusive right to tax savings income and corporate income.

I. The Evolution of the public finances of the Union

The hazardous evolution of the budget of the Union has already been studied in some detail.¹¹ Two are the main differences between the usual narrative

¹¹ See, among others, Isaac E. Druker: *Financing the European Communities*, Leiden, Sijthoff, 1975; Giovanni Zaccaria: *Il Bilancio della Comunità Europea*, Roma, Istituto de Gasperi, 1981; Francisco Fonseca Morillo: *El Presupuesto de las Comunidades Europeas: Análisis Jurídico*, Madrid, Instituto de Estudios Fiscales, 1986; Daniel Strasser: *Les finances de l'Europe*, Paris, LGDJ, 1990; Hellen Wallace: *Budgetary politics the finances of the European Communities*, London, George Allen and Unwin, 1981; Brigitte Laffan: *The Finances of the*

and the reconstruction put forward in this section. First, the analysis is focused on the provision of public goods by the institutions of the Union, and not on the nature of the Union. It is assumed that the decision to establish the Communities was based on the realisation¹² that the provision of certain public goods should take place at the European level, not at the national or regional level. The evolution of the budget of the Communities is telling of the evolution of the nature of the Communities, and not the reverse. Second, the actual evolution of the budget is analysed by reference to two basic criteria, namely, (1) which is the unit of taxation and expenditure; (2) which are the criteria according to which the tax burden and the expenditure is allocated.

The financial provisions of the Treaties that established the original three European Communities were rather fragmented. The Treaty establishing the European Coal and Steel Community granted a limited power to tax to the High Authority,¹³ so that it could levy taxes on coal and steel production.¹⁴ On its side, Articles 200 and 201 TEC and Article 172 TEAEC were somehow different. In the short run, the Treaties did not envisage the assignment of any power to tax to the Communities. The necessary revenue will be transferred by member states, according to variable scales. However, it was clear from the beginning that the European Community aimed at the creation of a single market among member states. The immediate and instrumental step was to establish a customs union among the six. Thus, the original provisions of the TEC hinted at the transfer of customs duties to the Communities, once the customs union will be a reality. However, Article 200 TEC conditioned the emergence of such a power to tax of the Community to a previous agreement among the member states. In a sense, the Rome and Paris Treaties foresaw a not so dissimilar financial arrangement for the Communities, but the Rome Treaties made room for a

European Union, Basingstoke, MacMillan, 1997; Jacques Mégret, *Les Finances de l'Union Européenne*, Bruxelles, Editions de l'Université Libre, 1999.

¹² Notice that the argument is not based on a strict causal claim, but on the interpretation of facts by the actors themselves.

¹³ This was later to be merged with the Commission of the other two Communities, and became the present Commission of the European Communities.

¹⁴ See Article 49 TECSC. The Commission made use of such power until 1997. It periodically reviewed the tax bases and rates, in accordance with the financial needs of the ECSC. The Treaty expired on July 23, 2002. It must be noticed that the ECSC Treaty also granted the power of borrowing money in the markets to the High Authority, in stark contrast with the rule of balanced budgets enshrined in Article TEC 199, section 3.

reconsideration of the financial arrangements before they became entrenched.¹⁵

In a first period (1951–64), one should distinguish between the financial practice of the ECSC and that of the other two Communities. The Coal and Steel Community had a rather simple budgetary structure. Both the administrative and the operating budgets were financed out of taxes directly collected by the High Authority. Such a practice remained almost unchanged until the expiry of the ECSC Treaty.¹⁶ The budgetary practice of the Economic Community and the EUROATOM was more fragmented. Their costs were financed originally through national contributions, the concrete amount of which was dependent on the extent to which each member state benefited from different policies.¹⁷ The two main *criteria* were those applicable to the budget of the Administrative Budgets (*the political scale*) and the Social Fund (*the social scale*). As a result, the units of taxation and expenditure in the first period were the member states, and the criteria of taxation and expenditure was the *benefit principle*, which follows the logic of commutative justice.¹⁸

(TABLE 1 AROUND HERE)

A first attempt at establishing a system of own resources took place in 1965. The date is not coincidental. Two important issues were on the agenda of the Communities. On the one hand, the permanent system of financing the

¹⁵ Druker argues that some “experimentation” was felt as needed before deciding on the financial arrangements of the rather more comprehensive Economic Community. See Druker, *supra*, fn 11, p. 241.

¹⁶ After the Merger Treaty, the administrative budget was financed through the unified budget of the three Communities.

¹⁷ Relevant provisions in that regard were Article 200(1) and (2) TEC, Article 203(5) TEC, Article 172 (1) and (2) TECAE, Article 177(5) TECAE; Implementing Convention on the Association of the Overseas Countries and Territories with the Community, annexed to the TEC, Article 7 and Annex A; Protocol on the Statute of the European Investment Bank, annexed to the TEC, Articles 4 and 10; Regulation No 5 laying down rules relating to calls for and transfers of financial contributions, budgetary arrangements and administration of the resources of the Development Fund for the Overseas Countries and Territories, JO 33, of 31.12.58, pp. 681–85; Internal Agreement on the financing and management of Community aid, JO 93, of 11.06.64, p. 1493; Internal Agreement on the financing and administration of Community aid, JO L 282, 28.12.70, p. 47.

¹⁸ Druker argues that the different patterns of contribution can be ‘explained’ by reference to the cumulative use of the ability to pay and voting rights criteria (Druker, *supra*, fn 11). He further claims that the implication was that, in economic terms, the original financing of the Communities had the same effects as an across the board Community tax. This will imply that criteria of distributive justice were creeping even at this early stage of the evolution of the system of public finance of the Communities.

emerging Common Agricultural Policy (hereafter, CAP) was scheduled to be decided in that year.¹⁹ The first step towards the realisation of the CAP had taken place in 1962. Several sectorial market organisations were created. Their costs were paid out of the European Agricultural Guidance and Guarantee Fund (hereafter, EAGGF)²⁰. This Fund was to be financed through a peculiar kind of national contributions in a transitory period of three years. The share of each member state was calculated partially by reference to the *political scale* and partially by reference to net value of imports of agricultural products coming under the already established sectorial market organisations.²¹ Even in the transitory period, the relative weight of the *political scale* was foreseen to diminish every year. This would lead to the actual accrual of levies imposed on agricultural products to the Fund, as stated in Article 2(1) of Regulation 25/62.²² On the other hand, there were some reasons to believe that the customs union might become a reality ahead of schedule. This inevitably elicited debate on the question whether the Communities should establish and collect customs duties, as hinted by the original text of Article 200 TEC. Both decisions were known to have implications for the powers of the European Parliament and, quite inevitably, for its way of election. A genuine power to tax could not be granted to the Communities if such a power was not democratically exercised. After all, *No Taxation without Representation* was a basic constitutional principle shared by all six member states.

National governments, and especially the French one, had rather conflicting preferences in these issues. The French government had rendered it unequivocal that the completion of the CAP and its financing through the budget of the Communities were regarded as *conditions sine qua-non* for their acceptance of European integration. At the same time, President De Gaulle was rather reticent towards the granting of a genuine power to tax to the Communities. This was especially unwelcomed if new powers will accrue to

¹⁹ See J H Weber, 'The Financing of Common Agricultural Policy', 4 (1966-67) *Journal of Common Market Studies*, pp, 263-88 and Druker, *supra*. fn 11, pp. 293ff.

²⁰ Regulation 25/62 on the financing of the common agricultural policy JO B 30, of 20.4.62, pp. 991-3.

²¹ Article 7 of Regulation 25/62.

²² "Revenue from levies on imports from third countries shall accrue to the Community and shall be used for Community expenditure so that the budget resources of the Community comprise those revenues together with all other revenues decided in accordance with the rules of the Treaty and the contributions of Member States under Article 200 of the Treaty. The Council shall, at the appropriate time, initiate the procedure laid down in Article 201 of the Treaty in order to implement the above-mentioned provisions".

the European Parliament. This was perceived not only as a step towards a federal Europe in itself, but also as a major shift in the institutional balance within the Communities. It was felt that this will result in the enhancing of the role of the Commission to the detriment of the Council. The Commission seems to have considered that contradictory preferences could be composed in such a way as to render palatable the establishment of a European power to tax. Such perception was reinforced by the positive experience with the major agreement on agricultural prices which had been reached at the end of 1964. In such a spirit, the Commission put forward a bold proposal in March 1965.²³ According to it, the European Parliament²⁴ would have obtained a genuine power to tax, extending to customs duties and agricultural levies. The Commission aimed at offering one single solution to the two pending questions in the agenda of the Communities. The supranational financing of the CAP and the establishment of the customs union were to take place in the same date (the Commission proposed anticipating the Customs Union by two years). By means of treating in a similar fashion the issue stemming from receipts deriving from the existence of customs, whether in the agricultural sector or others, the Commission opened the way to a rather extensive system of own resources. In fact, the proposal acknowledged that the system might provide the Communities with means well beyond its needs. Therefore, the Commission further proposed that eventual budgetary surpluses could be reallocated to Member States. However, the French government found the proposal deeply unsatisfactory and opposed to it firmly.²⁵ Other governments seemed to have preferred postponing any definitive agreement on the system of own resources.²⁶ A *financial deadlock* ensued, which played a major, if not the major role, in

²³ Proposal submitted by the Commission to the Council on 31 March 1965, 'Financing the Common Agricultural Policy', COM 865) 150, of 31 March 1965. Published at the *Bulletin EEC*, Supplement 5, pp. 2-11. See also Wallace, *supra*, fn 11, p. 52.

²⁴ The European Assembly of the European Coal and Steel Community, which had become the Assembly of the three Communities after the ratification of the Treaties of Rome of 1957, changed its name to European Parliament on 30 March 1962.

²⁵ Andrew Moravcsik: *The Choice for Europe*, Ithaca, Cornell University Press, 1997, p.184 seems to underestimate the *political* implications of the Commission's proposal: "In the early 1960s, it was above all Gaullist France that insisted on moving beyond long-term contracts, initially favoured by France as less 'supranational', to a more centralised Common Agricultural Policy managed and financed in large part by Brussels-based officials. *This involved a system of value-added taxation centralised in Brussels, a supranational power of taxation*". But De Gaulle knew better, and did not establish a necessary connection between a supranationally financed CAP and a supranational power of taxation, especially of *parliamentary* decided taxation.

²⁶ John Newhouse: *Collision in Brussels*, London, Faber, 1967, pp. 68ff.

precipitating the empty chair crisis.²⁷ The famous Luxembourg compromise managed to sideline the tax question and, at the same time, ensure a viable financial basis for the CAP, based on national contributions. The main consequence of the crisis was the actual postponement of a decision on the permanent system of financing the Communities. Agricultural levies were *de facto* transferred to the Communities. This was so to the extent that the relative weight of levies in the financing of the EAGGF was increased to 90%. However, the final status of customs duties was not decided, and would only be discussed once the customs union was fully in place. The same applied to the affirmation of the budgetary powers of Parliament.

The rejection of the proposal made by the Commission implied that the unit of contribution kept on being the member state. However, the financing of agricultural policy through the Communities' budget resulted in a transformation of the unit of expenditure. Agricultural aids benefited individual farmers or agricultural businesses, not member states. Moreover, the Merger Treaty of 1965²⁸ streamlined the budgetary structure of the Communities. Together with the *de facto* accrual of agricultural levies to the Communities, this had the not so indirect consequence of shifting the criteria of contribution and expenditure away from the benefit principle.

The scars of the financial battle rendered a political taboo further discussion of the system of own resources until 1969. With the resignation of De Gaulle in that year, French European policy started to shift considerably. The sharpest corners of inter-governmentalism were cut. This French shift paved the way to a reconsideration of the system of own resources. Several contemporary factors added further momentum. The accession of the United Kingdom (and other EFTA countries) was back in the agenda. The Customs Union was about to be completed and new policy initiatives were being considered. The political decision to establish a system of own resources was taken in the Hague summit of December 1969. The necessary treaty amendments were undertaken in two steps in 1970²⁹ and 1975.³⁰³¹ First, the Communities were

²⁷ Ibid. The book provides a rather detailed account of the crisis. It has its shortcomings, though, not unrelated to a fancy to predict.

²⁸ 'Treaty establishing a Single Council and a Single Commission of the European Communities', ('The Merger Treaty'), OJ L 152, of 13.07.67, p. 1.

²⁹ 'Treaty amending certain Budgetary provisions of the Treaties establishing the European Communities and of the Treaty Establishing a single Council and a single Commission of the European Communities, signed at Luxembourg on the 22nd day of April, 1970'. OJ L 2, of 2.1.71, p. 1 and Regulation

granted as own resources the revenues stemming from customs duties, agricultural levies and a certain rate (originally, one per cent) over the tax base of the newly born Value Added Tax. Given the existence of the Customs Union, the rationale for transferring the revenue yielded by customs duties to the Union was that there were no longer tariff reasons to export directly to each national European market. Exporters and importers could make full use of the economic advantage of certain locations as entry points of extra-European goods into the Communities.³² The same applied to agricultural levies which, *de facto*, had been almost communitarised after 1967.³³ On the other hand, the reason for making a percentage of the VAT collected in member states an own resource of the Communities was not so different. The economic transaction that triggers the liability to pay VAT is the sale of a good or service. As all sale taxes, VAT is collected on the assumption that such transaction reveals or betrays the *economic ability* of the purchaser of the good or service³⁴. Given that the creation of a common market was expected to increase trade not only across, but also inside borders, one could argue that part of such economic ability should be traced back to the common market. Therefore, consumption could be regarded as a not bad proxy of the benefit that individuals actually derive from the Communities in

(EEC, Euratom, ECSC) No 2/71 of the Council of 2 January 1971 implementing the Decision of 21 April 1970 on the replacement of financial contributions from Member States by the Communities' own resources, OJ L 3, of 5.1.1971, p. 1

³⁰ The background agreement was established in the Copenhagen Summit of December 1973. See 'Treaty amending certain financial provisions of the treaties establishing the European Communities and of the Treaty establishing a single Council and a single Commission of the European Communities, signed at Brussels on the 22nd day of July, 1975', OJ L 359, of 31.12.1977, p. 1.

³¹ Druker, *supra*, fn 11, p. 244 makes the interesting procedural observation that the amending provisions of the Treaties were established through a mixture of Community procedure and ratification by the Member States following their own constitutional provisions.

³² To refer only the standard example, the port of Rotterdam is a major port of entry of goods aimed at being sold in all member states. Given the potential dramatic increase in traffic and therefore in customs collected, and given that that is the result of the Customs Union, it seemed fair that the revenue reverted to the Union.

³³ The weightiness of these arguments is provided by the fact that almost nobody challenges anymore that customs duties and agricultural levies are European resources properly speaking. Although one might say that the recent increase in the percentage of the own resources which are kept by the collecting state on account of "collection costs" to 25% (from the previous 10%) might indicate an erosion of that belief. See 'Council Decision 2000/597/EC Euratom, of 29 September 2000 on the system of the European Communities' own resources', OJ L 253, of 7.10.2000, pp. 42-6, especially Article 2(3).

³⁴ This can be clearly seen by considering the rationales of the reduced or zero rates of VAT applied in the different member states. A recurrent argument is that the *basic* nature of the good or service implies that even those with a very limited ability to pay could not avoid incurring in the expense associated to the good or service in question. To use a clear example, the acquisition of basic food products is subject to a 0 rate in some countries, such as the United Kingdom. Because even the less well-off members of a society need to buy such basic products, buying such products does not necessarily reveal or betray an ability to pay.

the seventies. In their turn, national contributions were preserved only as means to balance the budget in a transitory period (originally expected to last from 1971 to 1974).

The Parliament was assigned considerable powers on budgetary matters. The 'democratic imperative' was doubly binding. On the one hand, it was considered that the members of the European Parliament should be directly elected, leaving behind the system of nomination by national parliaments.³⁵ On the other hand, the European Parliament should be granted the power to reject the budget bill, and to discharge the accounts of previous fiscal years. In addition, the Parliament was granted limited amendment powers, only really substantial concerning non-compulsory expenditure (i.e. expenditures not required by the Treaties themselves, which were not very important in relative terms).

The actual implementation of the system of own resources was not easy. Agricultural levies were transferred quite quickly. Customs duties on trade with third countries were progressively phased in the budget of the Communities in the period from 1970 to 1975. This resulted in a simultaneous reduction of the size of direct national contributions. But only in 1979 the VAT own resource was actually implemented.³⁶

The setting up of the system of own resources pointed towards a radical shift in the definition of the *unit of contribution*. According to the letter and the spirit of the first system of own resources, states would progressively cease to transfer their contributions to Brussels. When the system was fully implemented, the contributors to the coffers of the Communities would be individuals and corporations, either when paying their VAT or when paying customs duties or agricultural levies. The growing weight of VAT in the revenue side turned all European residents into European taxpayers, even if few were conscious of that. At the same time, the planned regional policy would consolidate regions as units of expenditure. Both transformations had

³⁵ See '76/787/ECSC, EEC, Euratom: Decision of the representatives of the Member States meeting in the council relating to the Act concerning the election of the representatives of the Assembly by direct universal suffrage', OJ L 278, of 8.10.76, pp. 1-4 and 'Act concerning the election of the representatives of the Assembly by direct universal suffrage', OJ L 278, of 08.10.76, pp. 5-11.

³⁶ See 'Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment', OJ L 145, of 13.06.77, pp 1-40; and 'Ninth Council Directive 78/583/EEC of 26 June 1978 on the harmonization of the laws of the Member States relating to turnover taxes', OJ L 194 , of 19/07/1978, p. 16, which postponed the date of implementation of the Sixth Directive until 1 January 1979.

their impact on the criteria of contribution and expenditure. On the one hand, VAT could be said (as has just been argued) to be an imperfect, but tolerable, proxy of the benefits that individuals derived from the existence of the common market (at least in the seventies). On the other hand, regional policy was based on criteria of distributive justice, to the extent that it was specially targeted towards the less developed regions.

However, the first system will be severally handicapped by the concrete way in which the VAT resource was designed. The Union was *legally* granted a share of the Value Added Tax collected within the Union. In *legal terms*, when any taxpayer proceeds to pay VAT, she pays in reality (at the very least) two taxes:³⁷ one due to the member state and another due to the European Union. However, this has been rendered rather obscure by the fact that the amount due to the Union is not determined as a percentage of the *actual* VAT being paid, but as a percentage of the VAT which *would be due* according to the so-called ‘harmonised VAT base’. The reason is rather simple. Due to the fact that the definition of the tax base of Value Added Taxation has not been not fully harmonised across the Union, the only way to ensure an equal contribution of European citizens through VAT is to define a harmonised tax base for the *sole purpose* of calculating the amount which *legally* belongs to the European Union. But this renders extremely elusive the European side of VAT. To start with, any sale tax is a rather silent tax, generally less painful (and less visible to) for taxpayers than personal taxes, such as the income tax. Moreover, VAT is collected by member states. If, on top of that, the percentage to be transferred by the state to the Communities is calculated not by reference to the actual VAT base, but by reference to an hypothetical base, the VAT resource comes closer to a national transfer, only this time calculated by reference to consumption of goods and services.

The extension of Community action into new policy areas and the enlargement of the membership of the Communities put considerable pressure on the newly born system of own resources. First, the full implementation of the CAP resulted in a major increase of the expenditure. The fluctuations of currencies further burdened the agricultural arrangements of the Communities. At the same time, the Communities either deepened or expanded their action into several policy areas, such as research, development

³⁷ Some Member States have a mechanism of sharing of VAT between the Member State and the Regions. This is the case of Germany and Spain, for example.

aid or fisheries. Moreover, partially on account of British pressure,³⁸ regional policy became part of the action of the Communities.³⁹ Second, the United Kingdom proved to be a reluctant new member. Political support towards membership could not be taken for granted among the two main British political parties, the main leaders of which were rather split on the issue.⁴⁰ A lot of the uneasiness revolved around (or was focused on) the British contribution to the budget of the Communities. Unfairness was claimed on the basis of comparing the amounts paid by Britons to European coffers with the European expenditure in the Isles.⁴¹ The alleged imbalance was used as an argument against accession, and later on, as a reason for secession. It is interesting to notice that such strategy of comparing budgetary inflows and outflows stemming from the European budget from and to a member state was rather weak until then. Nonetheless, it became entrenched as an allegedly accurate calculation of the costs of Europe for each member state.⁴² Third, the Treaties of 1970 and 1975 had given some power to the European Parliament in the budgetary process. However, democratic legitimation of the Budget was still basically doubly indirect, that is, through the consent of the executives of Member States in the Council. The *middle way* between further parliamentarisation and full Council control will result in further pressure on the system of own resources. Once elected through universal suffrage, and therefore invested with direct democratic legitimacy, the Parliament will start to make strategic use of its limited budgetary powers to obtain wider powers.

³⁸ See, for example, Joost Van Doorn: 'European Regional Policy: An Evaluation of Recent Developments', 13 (1975) *Journal of Common Market Studies*, pp. 391-401, especially at p. 400: Given that the criteria were found not very adequate for determining access to the funds from a regional perspective, "one is almost forced to accept the idea that the establishment of a Regional Development Fund is not so much an instrument to deal with regional disparities as a means to cope with national disparities from and payments to the Community budget". See also Gavin McCrone: 'Regional Policy in the European Communities', in Geoffrey R. Denton, *Economic Integration in Europe*, (London, Weinfeld and Nicholson, 1969), pp. 194-219; Trevor Buck, 'Regional Policy and European Integration', 13 (1975) *Journal of Common Market Studies*, pp. 368-78, pointing that the United Kingdom, Italy and Ireland were clearly the *net beneficiaries*; Hellen Wallace, 'The Establishment of a Regional Development Fund: Common Policy or Pork Barrel?', in Hellen Wallace, Carole Webb and William Wallace: *Policy-Making in the European Communities*, Chichester, Wiley, 1977, pp. 137-64.

³⁹ Council Regulation (EEC) 724/75 of 18 March 1975, establishing a European Regional Development Fund, OJ L 73, of 21.3.75, p. 1.

⁴⁰ See the very enlightening and entertaining account of Roy Jenkins: *A Life at the Centre*, (London, MacMillan, 1991), especially chapters 17 and 22.

⁴¹ See, for example, Marcus H. Miller, 'Estimates of the Static Balance of Payments and Welfare Costs of UK Entry into the Common Market', 57 (1971) *National Institute Economic Review*, pp. 69-83.

⁴² See Brian Ardy, 'The National Incidence of the European Community Budget', 26 (1988) *Journal of Common Market Studies*, pp. 401-29.

Thus, it is not surprising that the system of own resources was under continuous criticism ever since its inception. Not only it was challenged on account of its distributional unfairness, but it proved soon insufficient to finance the level of expenditure of the Communities. The Commission made several proposals to increase the revenue at the disposal of the Community, aiming at avoiding financial shortcomings, but also at unfolding the role of public finance in an integrated market.⁴³ No bold action was taken and the Communities experienced periodical bouts of financial malaise. The eighties were marked by several episodes in which the Parliament refused either the draft budget or declined to discharge the accounts of a previous budgetary year.⁴⁴

The British criticism was only appeased with the famous ‘rebate’, which substantially reduced the British contribution to the budget, in 1984.⁴⁵ The Commission argued repeatedly that the financial crisis was the result of an insufficient level of financing accruing to the coffers of the Communities. But a major increase in the budget took place after the decision to set economic and social cohesion as one of the goals of the Communities, as established in the Single European Act (which resulted in the amendment of Article 130 TEC).⁴⁶ In its wake, a second system of own resources was finally agreed

⁴³ The Commission established a study group which prepared the so-called MacDougall Report, ‘Report of the Study Group on the Role of Public Finance in European Integration’, Luxembourg, Office for Official Publications of the EC, 1977. The Report drew a “small public sector federation” under which the Communities budget will be around 7.5 to 10% of the Community GDP, assuming that all defense and research expenditure will take place at the European level. See also ‘Financing the community budget : the way ahead’, of 23 November 1978, *Bulletin of the European Communities*, Supplement 8/78.

⁴⁴ On this, see Daniel Strasser, *The Finances of Europe*, Luxembourg, Office for Official Publications of the European Communities, pp. 198ff. The Council and the Parliament ended up before the Court of Justice in 1984. The Court supported in its judgment the arguments of the Council. See Case 34/86, *Council of the European Communities v European Parliament*, [1986] ECR 2155.

⁴⁵ The Dublin European Council of March 1975 introduced a first correcting mechanism for the British contribution. The Dublin European Council of November 1979 further conceded additional ad hoc expenditure measures to the United Kingdom. See also the Conclusions of the Presidency of the Fointenebleau European Council. *Bulletin*, 6-84, pp. 7-13 (also available at http://cuej.u-strasbg.fr/forma/euroj/euro_ser/cons_01_42/29_fontainebleau_26_06_84.html). For the implementation of the British rebate, see Council Decision 85/257 of 7 May 1985 on the Communities' system of own resources, OJ L 128, of 14.5.85, pp. 15-17. See also Geoffrey Denton: ‘Restructuring the EC Budget: Implications of the Fointenebleau Agreement’, 22 (1984) *Journal of Common Market Studies*, pp. 177-40.

⁴⁶ Cf. ‘Communication from the Commission: Making a Success of the The Single Act- A New Frontier for Europe’, COM 87 (100), of 15.2.87. (popularly referred as the ‘Delors I’ initiative); and Report by the Commission to the Council and Parliament on the Financing of the Community Budget, COM (87) 101 final, of 15.02.87. See also ‘Efficiency, Stability and Equity: A Strategy for the Evolution of the Economic System of the European Community’, the report of the study group presided by Tomasso Padoa

upon in 1988.⁴⁷ The total amount of resources managed by the Communities was to augment. On the one hand, the European rate of VAT was raised (from up to 1% to up to 1.27%). On the other hand, a fourth own resource was introduced, in the form of a proportion of the national gross product of each member state. In the same year of 1988, the structural funds were established, a central element in the Commission Strategy.

The second system of own resources resulted in the formal re-affirmation (de facto, they never ceased to be so) of member states as units of contribution to the European budget. Structural funds turned regions into the second major unit of expenditure. However, the changes had the effect of reaffirming the redistributive character of both taxation and expenditure. Not only national contributions were calculated by reference to national wealth (even if applying a proportional, not a progressive, scale), but structural funds were of an openly redistributive nature.

A new system of own resources was agreed in 1993⁴⁸, and further amended in 2000.⁴⁹ On the expenditure side, the third system was marked by the setting up of the cohesion fund,⁵⁰ which implied a considerable increase of regional redistributive expenditure. The size of the fund was famously decided at the Edinburgh European Council.⁵¹ On the revenue side, after the 2000 amendment, the resources at the disposal of the Communities have been stringently capped, leading to their actual diminution in relative terms. The 2000 amendment has also led to the slow but steady growth of the relative weight of the fourth resource (now defined as Gross National Income,

Schioppa, Bruxelles, European Commission, 1987. It was latter published commercially by Oxford University Press, with a preface by Jacques Delors.

⁴⁷ See '88/376/EEC, Euratom: Council Decision of 24 June 1988 on the system of the Communities' own resources', OJ L 185, 15.7.88, pp. 24-8.

⁴⁸ The 'Interinstitutional Agreement of 29 October 1993 on budgetary discipline and improvement of the budgetary procedure', OJ C 331, of 7.12.93, pp. 1-10 contained the financial perspective from 1993 onwards; this was latter formalised into '94/728/EC, Euratom, Council Decision of 31 October 1994 on the system of the European Communities' own resources', OJ L 293, of 12.11. 94, pp. 9-13.

⁴⁹ See Council Decision 2000/597/EC, Euroatom, *supra*, fn 33.

⁵⁰ See Council Regulation (EEC) No 792/93 of 30 March 1993 establishing a cohesion financial instrument, OJ L 79, of 1.4.93, p.74 and Council Regulation (EC) No 1164/94 of 16 May 1994 establishing a Cohesion Fund, OJ L 130, of 25.05.94, pp. 1-13.

⁵¹ See the Commission initiatives: 'From the Single Act to Maastricht and Beyond: The Means to Match our Ambitions', COM (92) 2000 final, 11.02.1992 and 'The Community's Finances Between Now and 1997', Communication from the Commission to the Council and Parliament, COM (92) 2001 final, 10.03.1992. See Presidency Conclusions of the Edinburgh European Council, available at http://www.europarl.eu.int/summits/edinburgh/default_en.htm.

hereafter GNI),⁵² to the detriment of the third.⁵³ This implies a further affirmation of member states as the main unit of contribution to the European budget. Individuals keep on contributing through Value Added Taxation, but increasingly less so. On what concerns the expenditure side, the picture is much more complex, as private individuals and regions keep on being the main units of expenditure. The rise of the fourth resource entrenches the relevance of criteria of distributive justice, especially if one takes into account the efforts to establish a more accurate measure of what national wealth is, through GNI.

The main conclusion that can be established is that the finances of the Union have slowly but steadily come to resemble more closely those of a ‘mature’ political community. This is so for two main reasons. First, the number and relevance of the public goods financed through the budget of the Union has increased considerably. Second, contribution and expenditure have increasingly be attuned to distributive criteria; clear evidence of this can be found in the resort to GNI as the relevant yardstick to calculate the fourth resource, or the growth of expenditure with open redistributive purposes. Having said that, it is also necessary to notice that the evolution of the units of contribution and expenditure reflect that, despite the referred pattern of evolution, the budget of the Union is not fully comparable to that of a ‘mature’ political community. The come-back of member states as units of contribution, and the tendency to spend a good deal of the resources on regions, not on individuals, reveals the remaining tensions in the evolution of European public finances.

(TABLE 3 AROUND HERE)

2. The Modest Case

The modest case aims at financing the Union through taxes directly collected by the Union. In the jargon used in the first section, the modest case aims at affirming individuals as the main unit of contribution to the coffers of the

⁵² Council Regulation (EC) No 2223/96 of 25 June 1996 on the European system of national and regional accounts in the Community, OJ L 310, of 30.11.96, pp. 1-469. See point 8.94.

⁵³ The European rate of VAT was capped to 1% in 1993, and to 0.5% in 2000. The fourth resource operates as *residual*. What is not collected through the other three resources, is distributed according to the formula for the fourth.

Union. In legal terms, this implies (finally) implementing articles 200 and 201 TEC.

A) Expenditure should be fully financed through taxation (No expenditure without taxation)

It is widely accepted that the democratic principles require that taxes are consented by the representatives of taxpayers (this is the famous *no taxation without representation*). But it also requires that public expenditure is financed through taxation (*no expenditure without taxation*). Taxes give numeric expression to the costs of public services;⁵⁴ as such, they can be turned into a means of democracy. The tax decision-making process provides citizens with information on the objectives of public action. It invites further discussion of such aims, and necessarily implies a debate on how to finance them. Many authors have stressed that taxes are the means of financing public expenditure which fosters to a higher degree the democratic control of public institutions.⁵⁵

As has already been argued, the budget of the Union is mainly financed through transfers from the member states. VAT is legally a European tax, but the formula according to which the actual transfer of resources takes place reinforces the perception of the third resource as a mere transfer from member states coffers. As a result, the budget of the Union does not comply with the principle of no expenditure without taxation. Therefore, the present system of own resources must be regarded as an obstacle in the way towards the democratisation of the Union.⁵⁶ Moving towards a European system of taxes to finance the Union's budget will have the direct result of rendering more transparent what Europe does and what Europe costs. Moreover, it

⁵⁴ See Agustín José Menéndez, *Justifying Taxes*, Dordrecht, Kluwer, 2001, p. 126: "The whole set of tax norms or tax system can be seen by each individual as a complex formula that allows us to determine our respective share of the financial burden derived from the existence of the political community in a relatively easy way".

⁵⁵ See, for example, Cecil Douglass North and Barry R. Weigast: 'Constitution and Commitment: The Evolution of Institutions Governing Public Choice in XVIIth century England', in Paul Drake, Matthew D. McCubbins (ed.); *The origins of liberty: political and economic liberalization in the modern world*, (Princeton, Princeton University Press, 1998), pp. 16-47; and Nial Ferguson: *The Cash Nexus: money and power in the modern world: 1700-2000*, (London, Allen Lane and Penguin, 2000).

⁵⁶ The lack of transparency of the benefits and costs of Europe might explain a good deal of citizens' apathy towards European issues, clearly reflected in the poverty of the debate before the elections to the European Parliament, and of course in the rather low turnout in the said elections.

might also have the indirect effect of increasing the degree of participation in the European level of politics and, thus, the quality of European democracy.⁵⁷

B) Ensuring the allocation of the financial burden according to coherent distributional principles

As things stand, it is perfectly possible that two individuals with a similar level of income end up bearing a rather different share of the ‘costs of Europe’ depending on to which Member State they pay their taxes. On the one hand, the main ‘own’ resource of the Union is paid out of the general budget of each member state in proportion to the GNI. This means that the proportion in which each individual contributes to the budget of the Union depends (1) on the overall pattern of distribution of the tax burden within the member state to which she pays her taxes; (2) but also on the income level, relative to other member states, of the member state to which she pays her taxes.

The resulting distributional pattern is unsatisfactory for two reasons. First, Article 12 TEC rules out any discrimination on the basis of nationality. One should keep in mind that the majority of those residing in each member state are nationals of that state.⁵⁸ Under such circumstances, a system of own resources in which the tax burden bore by each individual depends on the state of residence (and therefore, in most cases, in her nationality) is in breach of Article 12 TEC. Next to the legal argument, it must be said that it is worryingly paradoxical that the costs of a set of institutional structures and policies aimed at dismantling unjustified national barriers is allocated according to nationality. Second, the constitutional traditions of the Member States coincide in affirming that the costs of providing public goods and services should be allocated among residents according to principles of distributive justice, mainly the benefit and the ability to pay principles. The present system of own resources is therefore inspired by principles alien to the common constitutional traditions. To the extent that the state of residence

⁵⁷ The debate on the institutional structure of the Union has tended to revolve around the so-called ‘question of the prince’. An implicit premise of many arguments is that the election of a “President” of the Commission or the Council will help to render citizens more interested in choices on European policy. But one can contest that the key factor to render issues interesting to citizens is “personalisation” of politics. Perhaps people might be interested once important decisions (such as decisions with an incidence on the level of taxation) are trusted to European institutions.

⁵⁸ With the only but relevant exception of Luxembourg, where the figures are less obvious.

makes a difference, it can be argued that the present system of own resources is contrary to the referred common constitutional traditions.

C) Enhancing the flexibility of the financial arrangements

The level of public expenditure in any political community depends on the most basic political choices made by its citizens. However, the marginal evolution of public expenditure depends on factual developments. The achievement of the very same political goals could be more or less costly depending on the factual circumstances prevailing at each time. A certain degree of flexibility of public finance arrangements is therefore necessary in order to adjust expenditure to external factual developments.

The influence of external factors can easily be noticed in the European context. The evolution of agricultural prices in world markets, or the degree of economic convergence of the less developed regions within the Union, have a considerable impact in determining the level of expenditure needed to achieve Community goals. However, the present system of own resources is extremely (and increasingly) rigid. The present system has been designed with the actual aim of limiting the level of resources available to the Communities.⁵⁹ It results in imposing into the Union a financial straitjacket, rather atypical for political communities.

A European budget financed through taxes collected directly by the Union will be more flexible. The Union could make use of its taxing power with a view to the structural needs of the European economy. Thus, European public expenditure could be used as part of an embryonic European macro-economic policy.

D) Transaction costs related to financial arrangements: from national interest to politics

⁵⁹ Moreover, this results in a *double* limitation of the competencies of the Union. To the direct constitutional limitation of its competences, one must add the inexistence of any leeway to increase the level of expenditure. Any time that a new task is assigned to the Union, a double agreement is needed: one on the substance, another on the means to undertake such task.

The present system of own resources distorts the calculation of the costs and benefits associated with the budget of the Union. First, the debate on the distributive implications of the budget turns around the so-called ‘national interests’ of member states.⁶⁰ This results in the obfuscation of debate, as national interests are difficult to define in a clear and stable manner.⁶¹ Moreover, this precludes the assessment of the budget according to more apt criteria, such as the benefit or the ability to pay principles. Second, as was already indicated, a comparison is usually made between the total amount of budgetary transfers and allocations from and to each member state. This precludes a proper consideration of non-budgetary transfers and allocations, which are likely to be higher quantitatively and qualitatively. There is no evidence that they follow the same pattern of budgetary transfers and allocations.⁶² Third, the *public* character of the goods and services provided by the Union tends to be neglected, something that leads to downplay the specificity of criteria of allocation of public versus private goods.

The allocation of a genuine power to tax to the Union will result in the affirmation of the individual (physical or legal person) as the main unit of contribution to the European budget. This will foster the allocation of the tax burden according to the more apt principles of benefit or ability to pay, and will result in the progressive marginalisation of arguments related to the scarcely operationalizable ‘national interest’. In its turn, this will promote a more legitimate and efficient government of the Union, for two reasons. First, the transaction costs of increasing or decreasing the level of expenditure will be reduced. The costs which will be incurred will be associated to the deliberation and negotiation of a budget, not the clearly higher ones proper

⁶⁰ It must be noticed that this contrasts starkly with the allocation of the tax burden within each Member State according to criteria of distributive justice.

⁶¹ See Frans Vanistendael: ‘Memorandum on the taxing powers of the European Union’, (2002) *EC Tax Review*, pp. 120-9, p. 126: “The result is that the decision making process in tax matters now consists of successive rounds of bargaining in which powerful Member States wear down the resistance of lesser Member States, until the latter agree under political and economic pressure. *This bargaining process has nothing to do with democratic decision making, neither at the national level, nor at the European level.* It does not in any way reflect the political preferences of the electorate at the national level. In addition, this process is used by Member States to continue some privileged tax regimes which serve their narrow national interest, but which are contrary to the general interests of many more other Member States and the establishment of free and fair competition in the Single Market”.

⁶² It suffices to consider that those member states which are net contributors to the European budget tend also to be net exporters, and therefore, tend to benefit intensively from the economic freedoms. I am not arguing that importers cannot benefit from the four economic freedoms. I am only pointing that the calculus of the benefits and costs for each member state is, if reasonable at all to undertake, extremely more complicated than what is usually assumed.

of a semi-clandestine negotiation in which the invocation of the national interest, whatever that might be, is common currency. Second, the quality of debates would probably increase. This might be so given that publicity will foster putting forward the pertinent normative and prudential arguments, proper of debates on the allocation of tax burdens.

3. The ambitious case

In normative terms, the ambitious case aims at enhancing the redistributive potential of the budget of the Union. It relies on the four-folded case for increasing redistributive transfers at the European level and on the claim that the Union has become the only level of government at which it could be possible to tax both legitimately and efficiently certain tax bases (that is especially true on what concerns capital income). In legal terms, it aims at realising the commitment towards social and economic cohesion enshrined in Article 158 TEC. As a consequence, the ambitious case calls for a thorough reform of the two sides of the European budget.

A) Towards distributive justice

a) Distributive justice as a principle immanent to the Community legal order

This section aims at showing that the European Communities, since their very inception, have realised policies aimed at redistributing economic resources within the European Union, and/or policies which have had considerable redistributive effects. It might be the case that European integration has been mainly obtained until now through *negative economic integration*, but one could say, at the very least, that there are some episodes of *positive economic integration*.⁶³ To put it differently, the existence of the

⁶³ The contrast between negative and positive economic integration is, in itself, rather problematic. A good criticism is to be found in Oliver Gerstenberg, 'Private Ordering, Public Intervention and Social Pluralism' in Christian Joerges and Oliver Gerstenberg (eds.), *Private Governance, Democratic Constitutionalism and Supra-nationalism*, Luxembourg, Office for the Official Publications of the European Communities, pp. 205-18 and Oliver Gerstenberg, 'Denationalisation and the Very Idea of Democratic Constitutionalism', 14 (2001) *Ratio Juris*, pp. 298-325. However, the term might be used merely to distinguish between regulations essentially aiming at market-making or at market-redressing. In that sense, it is used *descriptively* by Fritz Scharpf in his *Governing in Europe: Effective and Democratic?*, Oxford, Oxford University Press, 1999 and more

policies referred in this section rebuts the claim that European integration is a pure matter of market integration. Therefore, a proper reconstruction of such policies shows that the case for redistribution does not imply a radical change of the goals of European integration, but the further development of already existing policies. Article 158 TEC plays a key role in that sense. By means of affirming social and economic cohesion as fundamental principles of Community law, it provides the basic legal standpoint from which to reconstruct the set of policies mentioned in this section. In that sense, the case for a *redistributively aimed* power to tax of the European Union can be built on the *actual contents of Community law*.

Before offering a first reconstruction of the relevant policies, it must be said that the *causal* origin of the actual policies cannot be invoked as counterproof of the argument of this section. It might be very well the case that the different redistributive programs and activities might be the outcomes of pure bargaining among member states. Thus, the relevant provisions might have come into existence as side deals or pure pork barrel. But the key question is that, once they have been adopted and inserted into the body of Community law, these set of measures realise further the principle of social and economic cohesion of the Communities. The establishment of causal links and the proper reconstruction of legal provisions with a view to solve conflicts and coordinate action are two different things, not to be confused.⁶⁴

A close reading of the Treaty of Paris establishing the European Coal and Steel Community renders it clear that it foresaw a *planned* making of a common market in such goods. This implied direct consideration of the social implications of the project.⁶⁵ The Treaty of Rome, which tends to be

normatively (and in my view, wrongly) by Giandomenico Majone in his *Regulating Europe*, London, Routledge, 1996.

⁶⁴ One could further claim that any causal link is, after all, ultimately based on normative judgments. See Carlos Santiago Nino, *El Constructivismo Ético*, Madrid, Centro de Estudios Constitucionales, 1991. On the damaging effects of so-called “causal links”, see John Lewis Gaddis, *The Landscape of History*, Oxford, Oxford University Press, 2003.

⁶⁵ Alan Milward makes an interesting point concerning Belgium’s accession to the ECSC: “The Treaty of Paris can be understood not just as the diplomatic substitute for a peace treaty, but also as the moment when Belgium formally entered the mixed economy and so ratified the changes which had taken place in its government and society since 1944. It ratified the shift to public responsibility in management, to the incorporation of the labour force into that responsibility, and to *the commitment of the state to welfare and employment*, a ratification of change all the more striking in contrast to the earlier history of the coal industry”. In *The European Rescue of the Nation-State*, (London, Routledge, 1992), p. 83. He further comments on the specific welfare measures financed through the High Authority in pp.113ff. See also the

regarded as less *dirigiste*, partakes however of the same logic. To start with, the creation of a common European market on goods, service, labour and capital required the establishment of a regulatory framework at the European level. A clear even if modest (or may be not that modest) example of that is the affirmation of the principles of non-discrimination on the basis of nationality and the principle of equal pay for equal work. The *regulatory* implications of these two principles tend to be neglected because they are said to be bargaining concessions to, respectively, Italy (from where most immigrant workers were expected to come in 1957) and France (where the principle had already been entrenched in national law, and therefore, had an interest in making sure that it also applied across the Community, if only to avoid the competitive disadvantage from Member States paying less to working women). But even if mere bargaining concessions (something which is not that obvious if one inspects closely the historical record),⁶⁶ they implied a binding constrain on the actual unfolding of the common market. Moreover, measures explicitly aimed to correct the effects of the market in order to foster values such as social and economic justice were introduced already in the early days of the Communities. There are three obvious examples. On the one hand, the *European Investment Bank* and the *Social Fund* were established with the mandate to foster openly *market-redressing* objectives. Their financial means were (and keep on being) limited, but it is difficult to deny their explicit redistributive action. On the other hand, the establishment of CAP was already contemplated in the original Treaties. The actual setting up of the EAGGF had as its immediate effect the subjection of agriculture to a special regulatory framework, with major redistributive effects. European farmers were sheltered from world market pressures with the view of both improving the life standard of farmers and achieving food self-sufficiency. The redistributive character of CAP has been severely weakened in the last decade; associations of small farmers have constantly denounced that agribusiness has become the main beneficiary of the policy as it is designed.⁶⁷ The correctness of such assessments does not invalidate the claim that CAP

comprehensive Edward Duncan, 'Recent Developments in the Social Policy of the European Community', 4 (1966-67) *Common Market Law Review*, pp. 184-214.

⁶⁶ See Lise Rye Svartvatn, 'In Quest of Time, Protection and Approval: France and the Claims for Social Harmonization in the European Economic Community', 8 (2002) *Journal of European Integration History*, pp. 85-102.

⁶⁷ It must be noted that scepticism with the present shape of the CAP does not entail scepticism towards the idea of a Common Agricultural Policy. On this, more extensively, see José Bové: *Il Mondo non è in vendita. Agricoltori contra la globalizzazione alimentare*, (Milano, Feltrinelli, 2001).

was conceived as, among other things, a redistributive policy, intended to benefit the rather considerable percentage of the European population whose income depended on farming activities by the end of the fifties. Increasing the revenue of farmers was then clearly part of a strategy aimed at social cohesion.⁶⁸

The unfolding of European integration has further affirmed the role of the Communities in ensuring a certain degree of distributive justice within the Communities. The setting up of a Regional Development Fund was but the first of a series of measures explicitly aimed at redistributing resources towards those European regions which were structurally hampered to profit from the positive effects of the setting up of a common market. Cohesion and Structural Funds, as we saw, were established in 1988 and 1993, respectively. Once again, this has been rather neglected by a good number of scholars, which focused exclusively on showing that regional policy was the outcome of a side deal, first to appease the United Kingdom, later to make the Single Market and Economic and Monetary Union palatable to Spain, Portugal, Greece and Ireland.

Two further developments are constituted by the Single European Act and the Maastricht Treaty. First, a new chapter on 'Economic and Social Cohesion' was inserted in the Treaties after the entry into force of the Single European Act. As has already been hinted, Article 158 TEC is of utmost relevance, given that it affirms social and economic cohesion as goals of the Communities. This provides *the* legal basis around which to reconstruct all the scattered provisions underpinned by a *redistributive* logic. Second, the Economic and Monetary Union has reinforced the redistributive action of the Union. The literature has noticed the establishment of overtly redistributive cohesion funds in order to ease the transition towards Economic and Monetary Union for the less well-off Member States. But it has neglected that the actual creation of a new common currency implies a

⁶⁸ See, for example, Rosemary Fennell: 'Reform of the CAP: Shadow or Substance', 26 (1987) *Journal of Common Market Studies*, pp. 61-77, at p. 76 and Padoa-Schioppa (ed.), *supra*, fn 46, p. 133. The same could be said about the Financial Instrument of Fisheries Guidance, established once the Fisheries Policy of the Communities was developed. Although the amount of people working as fishermen has always been relatively small compared with the total population, fisheries have tended to be the main occupation in the relatively enclosed areas where such activity has been undertaken.

‘communitarisation’ of seigniorage revenue.⁶⁹ The permanent criterion of allocation of such rights will be a combination of population and size of the economy of each member state. This implies the acceptance of normatively inspired criteria, and the transcendence of the *status quo ex ante*, which would have required allocating a larger part of the rights to Germany, given the role of the Deutschmark as a reserve currency.

(TABLE 3 AROUND HERE)

Finally, the further expansion of the competencies of the Union stemming from the Maastricht Treaty has led to new pressures to intensify the redistribution of resources through the budget of the Union. Firstly, the introduction of a common foreign and security policy has also unleashed new pressures for the provision of goods through the budget of the Union. It has been argued repeatedly that the setting up of common military forces will require some degree of financial burden-sharing.⁷⁰ Such a claim also extends to foreign action in general.⁷¹ Secondly, the communitarisation of the ‘Schengen acquis’ has resulted in pressures to establish mechanisms of so-called ‘financial burden-sharing’ concerning the policing of external borders. The establishment of common rules concerning the entry of third country nationals within the territory of the Union rendered national borders European borders overnight. An immediate consequence is that national police officials actually guard European borders according to rules established

⁶⁹ See Article 32, Section 5 in relation to Article 29, Section 2 of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank; ‘Council Decision on the statistical data to be used for the determination of the key for subscription of the capital of the European Central Bank’, of 5 June 1998, OJ L 171, of 17.6.1998, p.33-4 and ‘Decision of the European Central Bank on the national central banks’ percentage in the key for the capital of the European Central Bank’, of 1 December 1998, OJ L 125, of 19.5.1999, p.33. The allocation of monetary income follows special rules in the period 2002-2006, to allow a progressive transition from the monetary income positions of National Central Banks in the period July 1999 to June 2001 to the definitive scheme under which their monetary income will be calculated according to the respective paid-up shares in the Central Bank’s capital. See ‘Decision of the European Central Bank, of 3 November 1988, as amended by Decision of 14 December 2000, on the allocation of monetary income of the national central banks of participating Member States and losses of the ECB for the financial years 1999 to 2001’, OJ L 336, of 30.12.2000, pp.119-121 and, especially, ‘Decision of the European Central Bank, of 6 December 2001, on the allocation of monetary income of the national central banks of participating Member States from the financial year 2002’, OJ L 337, of 20.12.2001, pp. 55-61, especially Article 4. See also Strauss Kahn, *supra*, fn 3, p.216.

⁷⁰ See Reflection Group’s Report, Messina 2 June; Brussels 5 December 1995; available at <http://europa.eu.int/en/agenda/igc-home/eu-doc/reflect/final.html>.

⁷¹ See, more recently, some of the debates in the Laeken Convention. Cf. CONV 356/02 (specially remarks by the Secretary-General of the Council, at p. 8ff) and the final report of the External Action Working Group, CONV 459/02, especially at pp. 28-9.

at the European level. The uneven extent to which member states do actually have terrestrial and maritime external borders results in an uneven assumption of the material and financial burdens of border policing. Quite paradoxically, this has been quickly noticed by political actors who are usually deeply sceptical of any further assumption of competences or financial responsibilities by the European Union.⁷² The European Council of Laeken pointed to the need to deal with the issue.⁷³ The Commission has already proposed the establishment of a European Corps of Border Guards and mechanisms to ensure the *redistribution* of the costs of border policing among Member States.⁷⁴ And the European Council at Seville seems to have endorsed such principles.⁷⁵ The argument has been repeated within the Laeken Convention.⁷⁶ Moreover, the principle of burden-sharing seems to have been extended uncontroversially to the area of asylum⁷⁷, and has been equally argued for regarding immigration in general.⁷⁸ Thirdly, there are scattered examples of how the increased scope of action of the Union is interpreted as a mandate for European solidarity. This can be seen clearly at work in the Council Regulation establishing the European Union Solidarity Fund.⁷⁹ Immediately after the floods that resulted in massive damage in central Europe in September 2002, the Commission proposed to reintroduce a

⁷² On the position of the arch-critic of the European Union, Umberto Bossi, see ‘Bossi, ultimatum al governo: “Basta immigrati, o salta tutto”’, *La Repubblica*, 19 March 2002. On the British Government position, see ‘EU backs joint action to stem illegal immigrants’, *Financial Times*, 14 June 2002.

⁷³ Conclusion 42 of the Presidency Conclusions of the Laeken European Council. Available at <http://ue.eu.int/Newsroom/makeFrame.asp?MAX=1&BID=76&DID=68827&LANG=1&File=/pressData/en/ec/68827.pdf&Picture=0>.

⁷⁴ See ‘Communication from the Commission to the Council and the European Parliament Towards an Integrated Management of External Borders of the Member States of the European Union’, COM (2002) 233 final, of 7.5.2002. Although the Commission seems to envisage a final stage in which the burden-sharing problem is sorted out by means of financing the operational costs through the European budget, it proposes to use the Union’s budget in the meantime to “establish a mechanism for *financial redistribution* between Member States” (p.20). See also ‘Minutes of the 1566th meeting of the Commission held in Brussels (Breydel) on 7 May 2002’, PV (2002) 1566 final, of 14.5.2002. At p. 21 the college of Commissioners is quoted as advocating the desirability of a contribution from the Community budget to the financing of surveillance measures at borders.

⁷⁵ See par. 31ff of the ‘Presidency Conclusions’ of the Seville European Council, SN 200/22, of 22 June 2002, pp. 9-10.

⁷⁶ CON 97/02, especially at p. 6. See also the final report of the Freedom, Security and Justice Working Group, CONV 426/02, p. 6.

⁷⁷ See the final report of the Freedom, Security and Justice Working Group, CONV 426/02, p.4.

⁷⁸ See, for example, CONV 386/02 and CONV 401/02.

⁷⁹ Council Regulation (EC) No 2012/2002, of 11 November 2002, establishing the European Union Solidarity Fund, OJ L 311, of 14.11.02, pp. 3-8. The proposal is to be found as COM (2002) 514 final, available as Interninstitutional File 2002/0228 (CNS) at <http://register.consilium.eu.int/pdf/en/02/st12/12157en2.pdf>.

mechanism of financial solidarity among Member States to cover the most urgent needs in the wake of natural catastrophes. The Explanatory Memorandum of the proposed Regulation stated that:

“We are a Community of peoples on the path to closer union. At the same time the Union is preparing for enlargement in the very near future. In the event of a major disaster it is only right and natural that citizens, Member States and countries with which accession negotiations are under way, as well as the Community institutions, feel a spontaneous urge to show the sympathy for the victims through practical gestures of financial solidarity in particular”.⁸⁰

All these are instances of actual redistribution taking place within the European Union. They constitute the empirical ground on which to claim that redistribution within the Union is possible, that it is already implicit in many policy areas and that there is an explicit rationale for it, namely, the principle of social and economic cohesion, which aims at balancing market-creation with market-redressing policies.

A first implication of this catalogue is that the argument that redistribution cannot take place within the European Union is plainly falsified. Moreover, those challenging the assumption of a redistributive role by the Union need to extend their critical attitude to the actual performance of the Union. They must either show *why the present state of redistribution is acceptable but further redistribution will not be acceptable* or why not even the present state of redistribution is acceptable. A second implication is that a proper look at the actual redistributive policies of the Union reveals the many inconsistencies in the argument of those openly opposing redistribution. The recent developments on the policing of external borders are very clear example in that regard. Finally, the catalogue of redistributive policies of the Union points to a very simple rationale for redistributing at the European level, namely, the need to introduce an element of coherence between the unit of market-making and the unit of market-redressing. To the extent that a good deal of the norms shaping markets are determined at the European level, there is a pressure and a rationale for introducing market-redressing measures

⁸⁰ Ibid, page 2. Romano Prodi argued that “[t]his is anything is a moment where a strong and visible sign of European solidarity is called for”. Press conference, Brussels, 28 August 2002, available at http://www.europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=SPEECH/02/359|0|RAPID&lg=EN&display=. See also ‘L’union européenne veut créer un fonds d’aide en case de catastrophe naturelle’, *Le Monde*, 21 August 2002.

at the European level. These arguments are further considered in the next two subsections.

b) Common Citizenship

The widespread range of public goods provided by the Union supports its claim to have become a political community. This dramatic shift is closely related (at the very least, in temporal terms, but not only) to the recognition of fundamental rights protection as one of the unwritten general principles of Community law,⁸¹ to the establishment of the citizenship of the Union in the Treaty of European Union⁸² and to the solemn proclamation of the Charter of Fundamental Rights of the European Union.⁸³

The common citizenship of the Union is reflected in the sharing of a common normative framework, the *acquis communautaire*, to be interpreted and reconstructed in the light of the fundamental rights of European citizens. Europeans share a good deal of common action-norms, in fact, most of the common action norms applicable to the action of each of them. The transformation of the Union into a *normative-legal community* has major critical normative implications.

The very fact of sharing common action-norms requires the establishment and adequate articulation of solidarity links among European citizens. This is so because it implies a normative claim to ensure the access of all European citizens to the set of economic resources necessary to ensure their meaningful participation in the deliberation and decision-making of common action norms.⁸⁴ The critical standard of democratic legitimacy of Community laws requires that all those affected by them have a chance to participate in the decision-making and deliberation of European norms. Such condition cannot be said to be minimally fulfilled if a part of the population is deprived of

⁸¹ See the well-known Case 29/69, *Stauder* [1969] ECR 419, paragraph 7 and Case 11/70, *Internationale*, [1970] ECR 1125.

⁸² Cf. now Article 17 TEC.

⁸³ OJ C 364, of 18.12.2000, p. 1. There is a growing literature on the charter. Embarrassingly, I refer to Erik Oddvar Eriksen, John Erik Fossum and Agustín José Menéndez (eds.), *Chartering Europe*, Baden-Baden, Nomos, 2003.

⁸⁴ See, for example, Jack Knight and James Johnson, 'What kind of political equality does deliberative democracy require?', in James Bohman and William Rehg (eds.), *Deliberative Democracy: essays on reason and politics*, Cambridge, MA, MIT Press, pp. 279-319, at p. 309 and James Bohman, 'Deliberative Democracy and Effective Social Freedom: Capabilities, Resources and Opportunities', in *ibid*, pp. 321-48, at p.325.

access to such economic resources, and, therefore, cannot be said to have had the chance to participate.⁸⁵

c) The redefinition of communities of risk

A basic goal of the European Union is the redrawing of the borders of economic activity at the European level. If the original program of the Coal and Steel Community and the Economic Community was mainly concerned with the free movement of goods and the free provision of services, the transformations taking place since the Single European Act have also led to the transcendence of national barriers on what regards financial markets. The legislative framework that defines the statute of corporations and limits their financial liability,⁸⁶ the norms concerning the establishment and prudential supervision of financial institutions⁸⁷ and the establishment and prudential

⁸⁵ However, such condition could be basically met at the national level, to the extent that national welfare systems across the Communities will ensure access to the said set of minimum economic resources.

⁸⁶ See First Council Directive 68/151/EEC of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community; Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent; Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies; Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies; Sixth Council Directive 82/891/EEC of 17 December 1982 based on Article 54 (3) (g) of the Treaty, concerning the division of public limited liability companies; Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts; Eighth Council Directive 84/253/EEC of 10 April 1984 based on Article 54 (3) (g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents; Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State; Twelfth Council Company Law Directive 89/667/EEC of 21 December 1989 on single-member private limited-liability companies. See also Council regulation (EEC) 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG) and Council Regulation (EC) 2157/2001, of 8 October 2001 on the Statute of the European Company. Also Communication from the Commission pursuant to the second subparagraph of Article 251(2) of the EC Treaty concerning the Common position of the Council on the adoption of a European Parliament and Council Directive on company law concerning takeover bids.

⁸⁷ See Directive 92/30/EEC on the supervision of credit institutions on a consolidated basis; Directive 93/6/EEC on the capital adequacy of investment firms and credit institutions; Directive 93/22/EEC of 10 May 1993 on investment services in the securities field, OJ L 141, of 11 June 1993, p.27, amended by Directive 2000/64/EC. Directive 94/19/EC of the European Parliament and the Council of 30 May 1994, on deposit-guarantee schemes; Directive 98/26/EC of the European Parliament and the Council on settlement finality in payment and securities settlement systems; Directive 2000/12/EC on the

supervision of insurance activities⁸⁸ is heavily determined by Community law. Together with the European provisions on the free movement of goods, the freedom of provision of services, and the rules on competition, they amount to a basic ‘economic constitution’, to a basic frame for the socio-economic order within the Union.⁸⁹

The making of a European market for goods, services and capital is therefore due to the effectiveness of Community law. Community legal norms have effects on the whole Union (and perhaps beyond the Union borders, but for the time being one can leave aside extra-territorial effects). The *making* of a common market has not only its benefits, but also its costs. *De facto*, it implies accepting (or at least tolerating) not only the common norms, but also the effects of such common norms. *De facto*, the making of a common market leads to the transcendence of national markets, but also to the diffusion of the associated risks to all residents in the Union.

This *de facto* transcendence of national communities of risk *should* have normative consequences. This is so to the extent that the institutionalisation of the protection vis-à-vis the economic risks stemming from the operation

taking up and pursuit of the business of credit institutions, OJ L 126, of 26 May 2000, amended by Directive 2000/28/EC, OJ L 275, of 27 October 2000; Directive 2001/108/EC of the European Parliament and the Council, of 21 January 2002, amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative procedures relating to undertakings for collective investment in transferable securities (UCITS), with regard to investments of UCITS. OJ L 41, of 13 February 2002, pp. 35ff. See also Regulation (EC) No 2818/98 (ECB/1998/15) on the application of minimum reserves, amended by Regulation EC 690/2002 of the European Central Bank of 18 April 2002. Directive 2001/24/EC of the European Parliament and the Council of 4 April 2001 on the reorganisation and winding up of credit institutions. See also the Communication of the Commission ‘Towards an EU Directive on the prudential supervision of financial conglomerates’ (MARKT/3021/2000) and the Proposal for a Directive of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC and Directives 98/178/EC and 2000/12/EC of the European Parliament and the Council, COM (2001) 213 final, of 24.04.2001. Communication from the Commission to the European Parliament and the Council upgrading the investment services directive (93/22/EEC), COM (2000) 729, of 15 November 2000. Communication from the Commission to the Council and the European Parliament ‘Clearing and Settlement in the European Union. Main policy issues and future challenges’, COM (2002) 257, of 28 May 2002.

⁸⁸ Directive 79/267/EEC, of 5 March 1979, on taking up and pursuit of the business of direct life assurance; Directive 91/674/EEC, of 19 December 1991, on annual accounts and consolidated accounts of insurance undertakings; Directive 98/78/EEC on the supplementary supervision of insurance undertakings in insurance groups. Common Position adopted by the Council with a view to the adoption of a Directive of the European Parliament and the Council concerning life assurance, 7328/02

⁸⁹ Cf. Miguel Poiars Maduro: *We the Court*, Oxford, Hart Publishers, 1998. See recently Julio Baquero Cruz: *Between Competition and Free Movement*, Oxford, Hart Publishers, 2002.

of free markets is a principle common to the constitutional traditions of all member states.⁹⁰ It seems to me that at the very least two implications can be individuated. On the one hand, the existence of a European-wide community of economic risks calls for the further development of market-redressing measures at the European level.⁹¹ The national character of the public insurance mechanisms related to basic economic risks needs to be further transcended in order to realise that the risks have become spread across the whole Union. This is reinforced by the fact that the persistence of redressing norms at the national level can hamper the maintenance of the common market. Thus, it can be said that the realisation of the internal market *determines* the level at which the public interest in redressing markets is to be realised.⁹² On the other hand, the basic rationale which supports the allocation of the power to tax over certain tax bases to the central tax authorities of the nation-state is subverted. In most member states, it has tended to be the case that the corporate tax, the capital gains tax, and the savings income tax have been resources of the central government. The main reason for this being so was precisely that the nation-state was the community of economic risk. However, we have just seen that most of the normative framework of the market economy has been transferred to the European level. This constitutes a good argument to (partially) transfer the power to tax capital income to the Union, as it will be practically argued in Section 5.

⁹⁰ This is proven by the inclusion of rights to solidarity in the Charter of Fundamental Rights. See Chapter IV of the Charter. On this, Agustín José Menéndez, 'The rights' foundations of solidarity: Social and economic rights in the Charter of Fundamental Rights of the European Union', Working Paper Arena 1/03, Oslo, University of Oslo. See also the European Social Agenda, OJ C 157, of 30.5.2001, pp. 4 ff.

⁹¹ Cf. paragraph 6 'Preamble of Council Regulation (EC) 2157/2001, on the Statute for a European Company (SE)', of 8.10.2001, OJ L 294, pp. 1ff, (6): "It is essential to ensure as far as possible that the economic unit and the legal unit of business in the Community coincide".

⁹² Cf. the Opinion of AG Geelhoed in Case C-491/01, *The Queen v. Secretary of State for Health, ex parte: British American Tobacco (Investments) Ltd and Imperial Tobacco Ltd supported by Japan Tobacco Inc. and JT International SA*, delivered on 10 September 2002, not yet reported, par. 106: "Proceeding on the assumption that a national measure such as that outlined in the preceding paragraph is justified by Article 30 EC, this will already mean that the barrier to trade exists. In order to set aside this barrier to trade, the Community legislature is entitled to adopt measures by which it takes over from the national legislature the protection of the matter of public interest (*in casu*, public health). In other words, the realisation of the internal market may mean that a particular public interest- such as here public health- is dealt with at the level of the European Union. In this the interest of the internal market is not yet the principal objective of a Community measure. The realisation of the internal market simply determines the level at which another public interest is safeguarded".

d) Stability: Redistribution as the price of European civilisation

The creation of a common market might have helped to foster the national protection of social rights, to the extent that peace and growth are the main preconditions of the welfare state, and the latter were rendered possible by European economic integration. Such a claim seems to be confirmed by the fact that, at the very least chronologically, the fostering of supranational markets came hand in hand with the affirmation of national social rights.⁹³ However, one must keep in mind that European integration has not resulted in the attribution of an autonomous competence to the Union to protect social rights. Redistributive policies are part and parcel of Community action, but they are still undertaken on the basis of a competence title associated to market integration. Moreover, Subsection a) in this section was devoted to *reconstruct* the breadth of redistributive policies in the Communities. It proves that the principle of social and economic cohesion is part and parcel of Community law. However, a *full-blown social policy is yet to be developed at the European level*.

Developments from the early seventies have revealed the tensions underlying a model in which national markets are merged into a single one, while the protection of economic and social risks is mainly reserved to nation states. A clear tension has emerged between supranational market-making and national social standards protection. On the one hand, the reinterpretation of the implications of free movement of capital undertaken in the 1988 Directive⁹⁴ and in the Treaty of Maastricht⁹⁵ might be inimical to the protection of social rights. Without regulatory disciplining forces on capital, there is no longer a guarantee that higher social standards would not lead capital to *escape* a given state or region. On the other hand, the lack of a robust *social dimension* in the European project might lead to active social dumping. As other regulatory competitive strategies are ruled out, national and regional lawmakers might try to increase investment flows by means of *reducing* the level of protection of

⁹³ I develop this further in 'Finalité through rights', in Eriksen, Fossum and Menéndez, *supra*, fn 83, pp. 30-47.

⁹⁴ See 'Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty', OJ L 178, of 8.7.88, pp. 5-18.

⁹⁵ See now Article 56 TEC. See also Sideek Mohamed, *European Community Law on the Free Movement of Capital and the EMU*, Dordrecht and Stockholm: Kluwer and Norstedts Juridik, 2000.

social rights.⁹⁶ Given the different levels of protection of social and economic rights in present and future members of the Union, the risk of active social dumping cannot be ruled out.⁹⁷

B) Matching legitimacy and ability to collect taxes

The overall level of taxation in the Member States of the European Union has tended to maintain a slow growth pattern in the last two decades.⁹⁸ This tends to be interpreted as an indicator of financial stability. This is also seen as discrediting the claim that the globalisation of financial markets undermines the tax capacity of nation-states.⁹⁹ But even if states keep on obtaining similar levels of revenue from taxes, it is also true that the actual tax mix has changed.¹⁰⁰ And it is difficult to contest that the globalisation of financial markets has played a role in such a transformation. On the one hand, the level of tax evasion seems to keep on growing, at the very least if one considers the figures for the black or shadow economy.¹⁰¹ This implies an increasing tax burden on the official economy, to the detriment of those who manage to escape the reach of the tax authorities. On the other hand, the actual level of taxation has been reduced for most capital income, while the taxation of labour income has tended to increase. This is sometimes neglected as ‘earned personal income’ is defined as comprising actual income derived

⁹⁶ Olivier De Schutter: ‘La contribution de la Charte des droits fondamentaux de l’Union européenne à la garantie des droits sociaux dans l’ordre juridique communautaire’, 12 (2001) *Revue Universelle des Droits de l’Homme*, pp. 33-47; Jacques Le Cacheux, ‘Social Protection, Tax and Social Competition in the European Monetary Union’, paper presented at the Instituto Elcano, Madrid, 3 March 2003, p. 9: “In a context of high unemployment, recourse to tax competition is likely to appear particularly attractive, insofar as tax reductions or rebates are usually regarded as ‘supplier-friendly’ tools to stimulate domestic economic activity”.

⁹⁷ It is even encouraged by some. See Ansgar Belke and Martin Hebler, ‘Towards a European Social Union: Impacts on Labour Markets in the Acceding Countries’, 13 (2002) *Constitutional Political Economy*, pp. 313-335.

⁹⁸ See *Revenue Statistics, 1965-2001*, Paris, OECD, 2002.

⁹⁹ See Fritz Scharpf: ‘The viability of advanced welfare states in the international economy: Vulnerabilities and options’, 7 (2000) *Journal of European Public Policy*, 190-228 and Sven Steinmo: ‘Globalization and Taxation: Challenges to the Swedish Welfare State’, 35 (2002) *Comparative Political Studies*, pp. 839-62.

¹⁰⁰ This is at the background of the tax policy of the Commission since the mid 1990s. See Mario Monti, ‘EMU, Taxation and Competitiveness’, London, 27 November 1998, especially at pp.4-5. Available at http://www.europa.eu.int/comm/taxation_customs/speeches/mario_monti_nov98_en.pdf.

¹⁰¹ See Friedrich Schneider, ‘The Shadow Economy’, forthcoming in the *Beitrag Encyclopedia of Public Choice*, available at <http://www.economics.uni-linz.ac.at/Members/Schneider/encyclopedia.PDF> and Friedrich Schneider and Dominik Enste, ‘Shadow Economies Around the World - Size, Causes, and Consequences’, CESifo Working Paper Series 196, CESifo, Munich, 1999.

from labour and personal capital income (such as savings income). This major transformation is basically due to the fact that the means to monitor tax bases (especially, capital income bases) have been substantially lost to nation states.¹⁰²

Only action coordinated by supranational political organisations could reverse this trend, and allow a proper quantification of certain tax bases. Given its regulatory function (or potentiality) of European markets, the Union is very well placed to be instrumental in ‘bringing back’ to the tax net the lost tax bases. The establishment of an automatic exchange of information among national tax authorities, coordinated by the Union, could prove a major step forward in that direction.¹⁰³

The institutions of the Union, and only the institutions of the Union, combine an effective capacity to tax certain tax bases and a potentiality to do so in a democratically legitimate way.¹⁰⁴ This does not necessarily mean that the power to tax should be shifted away from nation-states completely. It means that any solution requires ‘bringing in’ the European Union. But a the assignment of a limited but proper power to tax to the Union follows once the present argument comes hand in hand with the four ones presented in subsection A).

¹⁰² See, among others, Reuven Avi Yonah, ‘Globalisation, Tax Competition and the Fiscal Crisis of the Welfare State’, 113 (2000) *Harvard Law Review*, pp. 1575–1676 and Steven Olof Lodin, ‘What ought to be taxed and what can be taxed’, 54 (2000) *Bulletin for International Fiscal Documentation*, pp. 210–7. On the growth of international finance, see Eric Helleiner, ‘State Power and The Regulation of Illicit Activity in Global Finance’, H. Richard Friman and Peter Andreas, *The Illicit Global Economy and State Power*, Lanham, Rowman and Littlefield, 1999, pages 53–90; Robert Solomon, *Money on the Move*, Princeton, Princeton University Press, 1999; René Passet and Jean Liberman, *Mondialisation Financière et terrorisme*, Paris, Éditions de l’Atelier, 2002 and Sylvain Besson, *L’Argent Secret des Paradis Fiscaux*, Paris, Seuil, 2002.

¹⁰³ Cf. Proposal for a Council Directive to ensure effective taxation of savings income in the form of interest payments within the Community, of 18.7.2001, COM 2001 (400). In the meantime, a new political agreement has been reached in the Council to substitute automatic exchange of information for a 35% withholding tax (at a lower rate until 2010). on what concerns Austria, Belgium and Luxembourg. See ‘Results of Council of Economics and Finance Ministers, Brussels, 21st January 2003 – Taxation’, at http://www.europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=MEMO/03/13|0|RAPID&lg=EN&display= . Automatic exchange of information keeps on being the general rule, to be applied by other twelve member states.

¹⁰⁴ Notice that I refer to “potential”. One can say, with Habermas, that “expanding Europe’s political capacity for action has to happen simultaneously with the expansion of the basis of legitimation of European institutions”. See *The Postnational Constellation*, London, Polity Press, 2001, pp.99–100. See also Ronaldo Munck, *Globalisation and Labour. The New Great Transformation*, London, Zed Books, 2002, pp.85–6.

C) What the Ambitious case is not arguing for

Given the reticence towards European taxation and European redistribution, it is very necessary to make three caveats. This will render clear what the ambitious case *is not* about.

Firstly, the ambitious reformer does not aim at getting rid of redistribution at the national level. The aim is to create an interlocking system capable of redressing inequality¹⁰⁵ that protects national welfare states from the different external pressures at which they are subject, and at the same time furthers the achievement of equality across the whole area of the European Union. The underlying assumption is that the establishment of some form of European welfare state will not undermine national welfare states, but to the contrary, it will ensure the perpetuation of welfare states in the post-national constellation.¹⁰⁶

Secondly, the claim that the design of redistributive measures should have individual welfare as its basic reference does not imply that other units of redistribution should not be considered. Regional policies aimed at guaranteeing a homogeneous level of provision of public services are much needed as part of an overall scheme intended to ensure *fairness* within European society. The claim is not that regions and states are inadequate as units of redistribution, but that ensuring individuals access to a basic set of economic resources should *also* be part and parcel of the objectives of redistribution. And that such objective is, in normative terms, the *most* relevant one, even if at times it might be better achieved *indirectly*, through redistribution aimed at ensuring a homogeneous level of provision of public services.

¹⁰⁵ This should not be interpreted as denying the importance of public regulations that ensure fairness in the distribution of the economic production *directly*, such as labour laws. Dominique Strauss Kahn has recently argued that the relative neglect of such measures on the side of left-wing parties in the recent years explains the need for more redistribution of economic resources *ex-post*. See Strauss Kahn, *supra*, fn 3, pp. 71ff.

¹⁰⁶ Cf. Habermas, *supra*, fn 104, pp. 88: “We will only be able to meet the challenges of globalisation in a reasonable manner in the postnational constellation can successfully develop new forms for the democratic self-steering of society” and p. 105: Within a European Union that has assumed the character of a state, regardless of its multinational composition and the central roles of national governments, decisive policies of this sort would at least be conceivable”.

Thirdly, the ambitious case is not arguing for an overall higher level of taxation within the European Union. The European Union is expected to assume not only the power to tax certain tax bases, but also and contemporaneously, the obligation to redress some market results which were under the competence of Member States. Moreover, as it was argued in this Section, the granting of the power to tax to the Union will allow to ‘rescue’ some tax bases, which had been eroded as a result of the mixed combination of globalisation and Europeanisation. This will allow to reintroduce an element of fairness in the actual implementation of the tax system. Thus, it can be argued that granting the power to tax to the Union might have as a consequence the altering of the pattern of distribution of tax burdens within the Union, but not necessarily an overall increase of the tax pressure. A European power to tax could be implemented in such a way that it will (intentionally) not be Pareto optimal, but *redistributionally fair*.

4. Comparative Lessons: federal taxation in the United States

In the first section, it was claimed that the evolution of the public finance of the European Union is a good indicator of its slow but steady transformation into a mature political community. If this is so, it should be proper to compare the experience of the Union with that of other political communities with similar kind of federal or quasi-federal arrangements. In this section, I will argue that there are four concrete lessons that can be derived from looking at the American experience with federal taxation. The American Federal experience points to (1) the close relationship between the establishment of supranational institutions and the granting of the power to tax to the said institutions; (2) the effect of reinforcement of the power to tax of supranational institutions which stems from political mobilisation aimed at ensuring tax (and social) fairness; (3) the evolutionary emergence of a general principle of solidarity out of isolated redistributive measures; (4) the effect of reinforcement of the power to tax of supranational institutions which stems from the transcendence of national markets.

A) Federal institutions come hand in hand with a federal power to tax

The American case seems to indicate that the stability of federal or supranational institutional arrangements is closely related to the granting of a power to tax to the federal level of government. The failure of the ‘apportionment’ system established in the Articles of Confederation to ensure the flow of resources to the Continental Congress was regarded to support the case a federal level of government *with* a federal power to tax.

It is extremely well-known that the United States did not enter the political world as a federation, but as a confederation. And a rather modest one, for that purpose. The only actual confederal institution envisaged in the Articles of Confederation¹⁰⁷ was the Continental Congress (which not only predated the Articles, but actually authored them). No confederal executive or judiciary were contemplated.¹⁰⁸ The fact that the United States was a by-product of a war fought against an external arbitrary power to tax explains the limited scope of confederal power. Even the Continental Congress was extremely limited in its functions. Congress lacked any direct power to tax the citizens of the thirteen states.¹⁰⁹ The resources of the Confederation were to be apportioned to the states by reference to the value of land in each State.¹¹⁰ Similarly, Congress lacked any power to regulate commerce among states, which were left free to decide on exporting and importing duties.

These institutional decisions rendered hard to finance the war effort, especially to pay for confederal expenses. Continental Congress was expected

¹⁰⁷ The Articles were being discussed since the beginning of the War, but they only entered in force by 1881.

¹⁰⁸ The crude realities of the war, though, led to the nomination of secretaries of state for State, War and Finance, but there was no full-blown executive to speak of.

¹⁰⁹ Thomas P. Slaughter: ‘The Tax Man Cometh: Ideological Opposition to Internal Taxes, 1760-1790’, 41 (Third Series) (1984) *William and Mary Quarterly*, pp. 566-91, at p. 585 are among those making this obvious point.

¹¹⁰ Article VIII, my italics: “All charges of war, and all other expenses that shall be incurred for the common defense or general welfare, and allowed by the United States in Congress assembled, shall be defrayed out of a common treasury, which shall be supplied by the several States in proportion to the value of all land within each State, granted or surveyed for any person, as such land and the buildings and improvements thereon shall be estimated according to such mode as the United States in Congress assembled, shall from time to time direct and appoint. *The taxes for paying that proportion shall be laid and levied by the authority and direction of the legislatures of the several States within the time agreed upon by the United States in Congress assembled*”.

to obtain resources through the apportionment mechanism, but the states had sufficiently trouble financing their own expenditures that only one sixth of the amounts requested were actually forthcoming.¹¹¹ For example, Massachusetts were left with almost no other alternative other than the collection of taxes at levels higher than the ones foreseen in the acts of the British Parliament which gave rise to the war.¹¹² Under such circumstances, Congress was forced to resort to the issue of paper money¹¹³ and to obtain loans, especially from Holland and France. The amount of resources stemming from paper money tend to decrease, as the increasing speed at which it was issued by some states tended to reduce its exchange value.

As the war finally came to an end in 1783, both Continental Congress and most states were deeply indebted. To make things worse, the end of the war came hand in hand with an economic downturn, partially induced by the renewed scarcity of species. Several states introduced customs duties on import from other states. To put it with the Beards, states “went to extremes in their indifference to the fortunes of the Union”.¹¹⁴ Continental Congress was impotent. The requirement of unanimity for amending the Articles of Confederation blocked reform several times. Twice it was proposed that Continental Congress should be granted the power to levy a 5% custom duty, and twice the proposal was blocked by one single state (Rhode Island in 1782 and New York in 1784).¹¹⁵

Economic unrest also led to political mobilisation. While courts were flooded with debt collection claims, there was a major surge in favour of the suspension of debt collection, the lowering of taxes and the issue of paper

¹¹¹ Ralph Volney Harlow: ‘Aspects of Revolutionary Finance, 1775-1783’, 35 (1929) *The American Historical Review*, 46-88.

¹¹² Jack N. Rakove, ‘Parchment barriers and the politics of rights’, in Michael J. Lacey and Knud Haakonssen, *A Culture of Rights, The Bill of Rights in philosophy, politics and law, 1771 and 1991*, (Cambridge University Press, Cambridge, 1991), p. 122-3: “The irony of the Revolutionary predicament was precisely that to secure the great right to be free from parliamentary taxation and legislation, the Americans had to accept (at least over the short run), a host of economic restraints and financial measures far more onerous than anything Britain would have ever imposed”.

¹¹³ James Henderson: ‘Taxation and Political Culture: Massachusetts and Virginia’, 47 (Third Series) (1990) *William and Mary Quarterly*, pp. 90-114.

¹¹⁴ Charles A. Beard and Mary R. Beard, *A Basic History of the United States*, Doran, Doubleday, 1944, p. 123.

¹¹⁵ *Ibid* (Jones), p. 67.

money as a way of easing the economic depression.¹¹⁶ The huge power concentrated on state legislatures was started to be used by the newly enfranchised. Indebted small farmers and artisans became the political majority in a good number of Northern legislatures and a relevant minority in Southern ones, despite the property or taxpaying conditions included in most state constitutions.¹¹⁷

Under such circumstances, the case for a stronger federal government and for the allocation of powers over tax (and commerce) to the federal government came to be regarded as inseparable. The outbreak of the Shays Rebellion in Massachusetts in 1786 and 1787 provided further evidence of the instability of the Confederal arrangements. Heavy taxes and strict debt collection had created explosive conditions among farmers. Only the intervention of the army prevented the triumph of the rebels. The occasion was seized by those who would be known as the Federalists to make the case for a revision of the Articles of Confederation. Congress asked states to send delegates to Philadelphia in May 1787 to discuss the needed changes. Advocates of a major transformation of the confederal level of government were a majority among the members of the Convention. Indeed, the Federalists made of the allocation of the power to tax to the federal government one of their central claims.¹¹⁸ But their claims meet opposition, not only during the Convention but also, and especially, during the ratification process. The Antifederalists kept on rejecting both the entrenchment of a federal level of government, and the allocation of a full-blown power to tax to it.¹¹⁹ Federalists managed to ensure that the federal level of government will have not only a legislature,

¹¹⁶ Priscilla Murolo and A Ben Chitty, *From the Folks who brought us the weekend*, New York, New Press, 2002, p. 25.

¹¹⁷ Maldwin A. Jones, *The Limits of Liberty*, Oxford, Oxford University Press, 1983, p.63.

¹¹⁸ See Federalist, 12 (page references are to the edition of Isaac Kramnick, Harmondsworth, Penguin, 1987, pp. 137-8): "A nation cannot long exist without revenues. Destitute of its essential support, it must resign its independence, and sink into the degraded condition of a province", Federalist, 30 (p. 212-3): "A complete power, therefore, to procure a regular and adequate supply of it, as far as the resources of the community will permit, may be regarded as an indispensable ingredient in every constitution" and Federalist, 31 (p. 218): "As theory and practice conspire to prove that the power of procuring revenue is unavailing when exercised over the States in their collective capacities, the federal government must of necessity be invested with an unqualified power of taxation in the ordinary modes". See also J Paterson, in *Hylton*, supra, fn. 2, at 178: "The government of the United States could not go, under the confederation, because Congress was obliged to proceed in line of requisition (...) Requisitions were a dead letter, unless the state legislatures could be brought into action; and when they were, the sums raised were very disproportional". Paterson established a direct comparison with the Netherlands.

¹¹⁹ See Saul Cornell, *The Other Founders: Anti-Federalism and the Dissenting Tradition in America, 1788-1828*, Chapel Hill, University of North Carolina Press, 1999, p.31 and 160.

but also an executive and a judiciary. Simultaneously, they scored a major victory on the tax front. Article I, Section 8 of the Constitution assigned to Congress the power to “lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defence and general welfare of the United States”. Together with the power to regulate trade, the power to tax constituted one of the foundations of the new federal level of government.¹²⁰

The shape and limits of the federal power to tax has been the object of political discussion (in fact, legal limits have been remarkably thin),¹²¹ but the granting of a power to tax to the federal government has not been challenged as a matter of principle. The affirmation of a federal power to tax has played a major role in moments of crisis, providing the federal government with critical means in those circumstances. Moreover, discussions on the actual exercise of the power to tax have been central to political mobilisation and dispute in the United States. In that sense, the federal power to tax can be said to have contributed to the legitimacy and the efficiency of the political community *as a whole*.

Having said that, it remains to be added that there are some limits to the extent to which we can draw a conclusive lesson to the European from the federal experience. This is so because the close association between the establishment of a genuine federal government and its assignment of a power to tax was centrally based on a *prudential* argument. In fact, the case argument against apportionment was based on the lack of an appropriate criterion according to which to split the costs of the confederation among states. It is worth quoting at length from *The Federalist*:

“Those who have been accustomed to contemplate the circumstances which produce and constitute national wealth, must be satisfied that there is no common standard or barometer by which the degrees of it can be ascertained (...) The consequence clearly is that there can be no measure of national wealth and, of course, no general or stationary rule by which the ability of a state to pay taxes can be determined”.¹²²

¹²⁰ See J Chase in *Hylton v. The United States*, 3 Dall 171, at 358: “The great object of the Constitution was to give Congress a power to lay taxes to the exigencies of government”.

¹²¹ The Supreme Court has been rather reluctant to review the constitutionality of taxes collected by the Federal government. See Bruce Ackerman, ‘Taxation and the Constitution’, 99 (1999) *Columbia Law Review*, 1-57, at p. 51.

¹²² *Federalist*, 21 (p. 174-5).

The experience of the European Communities (and indeed, of contemporary nation-states) proves that it is possible to develop the “common standard” according to which to measure both personal and national income. The rise of personal income tax as a central tax figure in most Western tax systems came hand in hand with the development of means of assessing the said income. The introduction of a fourth ‘own resource’ of the Union, proportional to national income, has also come hand in hand with the appropriate technical means of measuring GNI. Moreover, the experience of the Communities shows that such a system can be very stable even in the absence of actual coercive means to enforce the actual payment of national contributions to the central budget. Therefore, it is beyond doubt that this concrete Federalist argument is no longer correct.

Still, the Federalist case for the granting of a full-blown power to tax to Congress was based on three further reasons which are, within certain limits, fully applicable to the Union. First, the Federalists were concerned about the *sufficiency* of the revenue of the Federation. This constituted a case in favour of the granting of a general power to tax, and not of the power to collect a specific tax, which could prove financially insufficient. The financial crisis of the eighties point to the rigidities of a system with capped revenue and almost no room for borrowing.¹²³ Second, the Federalist claimed that distributional fairness in the allocation of the tax burden would be easier to achieve if Congress taxed American citizens, rather than if resources were transferred by states. This was a further reason to give Congress a general power to tax.¹²⁴ We have observed the extent to which how much each citizens pays of the costs of Europe depends on her residence (which tends to be, in most cases, her nationality). Finally, the Federalists were of the view that the public credit of the Federation will crucially depend on its power to tax.¹²⁵ At present, the Union is bound to run a balanced budget. If that provision would be eventually lifted, it is clear that the capacity to borrow would depend of the breadth and scope of the power to tax of the Union.

¹²³ Federalist, 34 (p. 227): “There ought to be a capacity to provide for future contingencies as they may happen”.

¹²⁴ Federalist, 31, 32 and 34, especially at the end of 32 (p. 222) and 34 (p. 230).

¹²⁵ Federalist, 30 (p. 215): “It is not easy to see how a step of this kind could be avoided; and if it should be taken, it is evident that it would prove the destruction of public credit at the very moment that it was becoming essential to the public safety”.

B) Concern for tax fairness tends to reinforce the power to tax of the federal level of government

It is interesting to notice that, despite the text of the 1787 Constitution, the exercise of the federal power to tax was rather circumscribed. It remained residual until 1913.¹²⁶ Except for war emergencies (foremost the Civil War)¹²⁷, the three main sources of federal revenue were customs duties, excises on alcohol and tobacco and proceedings from the sale of land. Customs duties were the main source of revenue; they accounted for half of the federal revenue, and even for more before the Civil War.¹²⁸ The only exceptions can be found under the early Federalist rule.¹²⁹ Moreover, the proceedings of federal taxes were rather modest. The economic weight of the federal government did not go beyond 2 to 3 per cent of the size of the economy, and it did not account for even half of the total public expenditure in the United States.¹³⁰

Thus, we can say that the American federal government made a rather sparse use of its power to tax, especially if we compare the revenue proceedings of the XIXth century with those of most of the last century. With the European Union in mind, we could even feel tempted to say that the kind of taxes collected and the amount of national income at the disposal of the federal government were not so dissimilar from those of the Communities today.¹³¹ At any rate, it becomes interesting to consider what led to the *great transformation* of the American federal power to tax. The claim here is that an important part of the answer is to be found in political mobilisation aimed at

¹²⁶ See W. Elliot Brownlee, *Federal Taxation in America*, Cambridge, Cambridge University Press, pp. 16ff.

¹²⁷ Federal expenditure reached 15% of the national product during the civil war. Ibid, p. 23.

¹²⁸ Richard Sylla: 'Experimental Federalism: The Economics of American Government', in Stanley L. Engerman and Robert E. Gallman (eds.): *The Cambridge Economic History of the United States, volume II: The Long Nineteenth Century*, (Cambridge, Cambridge University Press, 1999), pp.483-541, at pp. 514-5.

¹²⁹ The introduction of a whiskey tax in 1791 resulted in a new tax rebellion. The direct tax on property was not saluted with enthusiasm either. Jefferson put an end to the attempt at creating a diversified federal power to tax after his election to the Presidency in 1801.

¹³⁰ However, it must be added that the level of local and state taxation and expenditure was also extremely modest. The economic weight of states was smaller than that of the federal government, while local authorities tended to collect and spend more money. However, differences were large among different local authorities. See Sylla, *supra*, fn 128, at pp. 505-8.

¹³¹ Which is only apparently correct, given the different relative weight of *overall* public expenditure in the United States then and in Europe now, and of course, given the completely different structure of the economy now and then.

ensuring greater fairness in the distribution of the tax burden and greatest economic justice. Such mobilisation aimed at and resulted in the strengthening of the federal power to tax.

The unfolding of industrialisation in the United States led to a growth in the economic weight of the federal state. This upward trend of federal public expenditure was especially intense after the Civil War.¹³² It was financed through repeated increases of customs duties. High tariffs helped protect nascent industries, but had severe distributional implications, which further added to the economic hardship experienced by the masses. Intense debates around socio-economic policy ensued. Those advocating some form of redistribution of economic resources put forward different economic proposals. Third party progressive parties advocated for some years the cause of *soft money*, be it paper money or silverism, as a means of easing the fortunes of the less well-off.¹³³ But opposition to the rise of tariffs on distributional accounts emerged slowly but steadily as a political demand. Personal and corporate income taxation, burdening the better-off, was regarded as a *progressive* alternative to *regressive* tariffs, which burdened the consumption of the less well-off. As a new recession was being felt, a very modest (2% on income over \$4000) Income Tax provision was included in the 1894 Wilson-Gorman Tariff.¹³⁴ Quite unexpectedly, the Supreme Court reversed its traditional deference to the federal power to tax, and declared in *Pollack* that the Income Tax was unconstitutional.¹³⁵ This delayed the cause of reform, but did not stop it. Revenue needs led to a National Inheritance Tax in 1898, which remained in force until 1902¹³⁶. Political support for a constitutional amendment which will overrule *Pollack*, and entrench the federal power to collect an income tax increased. Social unrest was reflected in the close 1912 Presidential race, with Theodore Roosevelt running as third man and attacking the monopoly power of corporations.¹³⁷ The Sixteenth Amendment

¹³² Brownlee, *supra*, fn 126.

¹³³ Gretchen Ritter: *Goldbugs and Greenbacks. The Antimonopoly Tradition and the Politics of Finance in America*, Cambridge, Cambridge University Press, 1997.

¹³⁴ See, for example, Brownlee, *supra*, fn 126, p. 38.

¹³⁵ See the two judgments on *Pollock v. Farmers' Loan Trust & Co.*, 157 US 429 (1895) and 158 US 601 (1895). On the case, its background and aftermath, see Owen Fiss: *The Troubled Beginnings of the Modern State*, New York, MacMillan, 1993, especially pp. 75-100.

¹³⁶ And which was cleared by the Supreme Court in *Knowlton v. Moore*, 178 U.S. 41 (1900).

¹³⁷ Brownlee, *supra*, fn 126, p. 43.

was ratified in 1913. This led to the adoption of a modest income tax *aimed at replacing the fall of revenue* derived from a reduction of tariffs.¹³⁸

All this confirms that political mobilisation aimed at ensuring distributional fairness in the allocation of the tax burden played a major role in dispelling any doubts concerning the power to tax income of the federal government. This created the conditions under which income tax became the main source of revenue of the federal government, and under which the federal government could not only pay for two wars, but also expand the role of the state in the distribution of economic resources during and after the New Deal.

c) Isolated redistributive measures might lead to the emergence of a general principle of solidarity

In Section 3.A.a, it was claimed that social and economic cohesion is a basic principle of Community law, and that it is around that principle that we should reconstruct a series of institutions and policies already in existence. Social and economic cohesion has been affirmed step by step in the Union. The American experience is not that different in this regard. A series of policies and institutions which might have been established as side deals led, step by step, to the emergence of a more general principle of solidarity underpinning the action of the federal state. As recent scholarship has stressed, measures such as natural relief acts¹³⁹ and the provisions of pensions for war veterans and war widows¹⁴⁰ were the result of crude political bargains, but they laid the ground for arguments in favour of more extensive and centralised redressing of market distributive outcomes. Such measures did not only reflect an element of market-redressing, but they also made people

¹³⁸ It is rather telling that the income tax was part of a tariff bill both in 1894 (*Wilson-Gorman Tariff*), 1909 (*Payne-Aldrich Tariff*) and 1913 (*Underwood Tariff*).

¹³⁹ Michele L. Landis: 'Fate, responsibility and 'natural' disaster relief', 33 (1999) *Law and Society Review*, pp. 257-318.

¹⁴⁰ Theda Skocpol: *Protecting Soldiers and Mothers, The Origins of Social Policy in the United States*, (The Belknap Press of Harvard University Press, Cambridge, Massachusetts, 1992) and 'From Beginning to End: Has Twentieth Century U.S. Social Policy come full circle?' in Morton Keller and R. Shep Melnick: *Taking Stock: American Government in the Twentieth Century*, (Cambridge University Press, Cambridge, 1999), pp. 249-79; Ann Shola Orloff: 'The Political Origins of America's Belated Welfare State', in Margaret Weir, Ann Shola Orloff and Theda Skocpol: 'The Politics of Social Policy in the United States', (Princeton, Princeton University Press, 1988), pp.37-80.

aware of the actual boundaries of the community of risk, which had been expanded as the size of economic activity did so.

The American experience further proves that the emergence and development of such principle of solidarity tends to facilitate the strengthening of the taxing and spending powers of the federal government. More ambiguously, the institutional and policy legacies of such arrangements might constitute an obstacle to change.

D) Transcending national communities of risk leads to a reinforced federal power to tax

The American federal experience further suggests that the actual expansion of the breadth and scope of economic markets leads not only to a national market for goods and capital, but also to a wider community of economic risk. This results in a reinforced pressure for establishing schemes of redistribution financed by the federal level of government.

Such kind of claims can be traced back to the aftermath of the Civil War. And it has already been indicated that fragmentary and embryonic federal welfare programs were established from that date.¹⁴¹ Progressive movements kept on demanding further social justice. It was only after the Big Depression that mature welfare arrangements were institutionalised and *constitutionalised*¹⁴². It is interesting to notice is that the New Deal was characterised by the introduction of both market making and market redressing legislation at the federal level. To put it in the terms used in Section 3.A.c, it was during the New Deal that a conscious attempt was made at ensuring that the *economic* and the *legal* unit were the same. This is reflected in the regulation of corporate structures and financial markets, but also in the introduction of the basic elements of redistribution, such as the Social Security Act of 1935.¹⁴³

¹⁴¹ See references in fn 140.

¹⁴² Bruce Ackerman: *We The People*, Cambridge, MA, Harvard University Press, 1991 and 1999, volume 1, chapter 5 and volume 2, chapter 10. See also Frank I. Michelman: 'Foreword: On Protecting the Poor Through the Fourteenth Amendment', 83 (1969) *Harvard Law Review* 83:7-59.

¹⁴³ David M. Kennedy, *Freedom from Fear. The American People in Depression and War, 1929-1945*, New York and Oxford, Oxford University Press, 1999, pp. 249ff. Kennedy refers that Roosevelt regarded the Social Security Act as the "cornerstone of his administration".

The establishment of a *regulatory framework* at the federal level for commercial and financial enterprises is a good indicator of the emergence of a federal community of risk. This was not dissociated from the arguments in favour of a federal system of taxation aimed at the redistribution of resources *within* the Federation.

5. From theory to design

The ultimate test of a critical normative argument comes when it is time to transform reality. Practical reason is not only *reason*, it is also *practical*. So it is pertinent to provide some indications of how the arguments put together in this argument can be implemented in practice, that is, what concrete reform proposals they would support. This requires that I proceed in three steps. First, I will determine which are, in the light of the present argument, the main shortcomings of the actual system of own resources of the Communities. Second, I will indicate which are the desirable general features of tax figures to be transferred to the Union. Or what is the same, which normative and prudential tests they should be able to overcome. Third, I will point to two concrete taxes that should be transferred to the Union.

A) The shortcomings of the present system of own resources

The present system of own resources is in fact a system of resources, but not of *own resources*. As it was detailed in Section 1, member states were expected to stop contributing directly to the coffers of the Communities once the first system of own resources was fully implemented. This was never the case, due to the perennial insufficiency of customs duties, agricultural levies and the VAT. Since the mid 1980s, national contributions have *formally* been back. In the third system of own resources, especially after the 2000 amendment, they are expected to become the main source of finance of the Union. It is the very important fact that *criteria of distributive justice* have come to permeate the allocation of national contributions that prevents us from deriving that the public finances of the Union have not made a full circle since 1970.

Two are the main reasons for this state of affairs. First, as was already indicated, the VAT resource was designed in such a way that it was extremely unlikely that European citizens would come to regard it as a European tax, and not as a mere formula according to which national contributions are calculated. The tax was not only collected by the member states, but the ‘European share’ was determined by reference to an hypothetical VAT base, not by reference to the actual amount of the economic transaction which gives rise to VAT liability. To put it briefly, the Europeanness of the VAT was far from *visible* to European citizens. Second, the VAT resource was open to criticism on its *distributional unfairness*. Most sales taxes tend to be regressive in distributional terms. This is so because the better off tend to consume a lesser part of their total income.¹⁴⁴ If sale taxes are collected at a proportional rate, then your sale tax liability tends to increase in relative terms the less your income level is. This *distributional weakness* of VAT was ably exploited by staunch critics of the first system of own resources, such as the British government. Next to the *juste retour* argument, British criticism focused on the alleged *distributional unfairness* of VAT as a means of distributing costs among *nation-states*. This argument was based on the (at the very least contestable) projection of *distributional unfairness among individuals* to *distributional unfairness among nation-states*. At any rate, the *distributional unfairness of VAT* rendered it extremely vulnerable to discourses based on distributional fairness, be it among individuals or among states.

B) What general features for European taxes?

On the basis of the shortcomings of the present system of own resources, it seems clear that normatively sound and prudentially advisable European taxes should meet two main properties. First, the *Europeanness* of the taxes should be *visible*. This strongly recommends taxes that could be associated with the public goods delivered by the Union. At the present early stage of development of the public finance of the Union, the case for taxing at the European level should be implemented through the allocation to the Union of tax bases related to the problem-solving capacities of the Union. This does

¹⁴⁴ This is, of course, not applicable to sale taxes which are collected on aggregated levels of consumption over a certain period, and which allow for the application of progressive rates. See, for example, Edward McCaffery: ‘Real Tax Reform: The case for a progressive consumption tax’, 25 (1999) *Boston Review*, available at <http://bostonreview.mit.edu/BR24.6/mccaffery.html>.

not imply that taxes should be modelled as prices for public goods,¹⁴⁵ or that the Union is a purely problem-solving entity.¹⁴⁶ The claim is merely that if there is a clear connection between European taxes and European public goods, the case for allocating the tax base to the Union *is simpler*, and therefore, *more visible*. Second, taxes to be transferred to the Union should be *progressive in distributional terms*. European taxes should be among those which clearly operationalize the idea that is fairer that the better-off pay a higher share of their income in taxes than the worse-off. If that is so, European taxes will not be easily criticised on the basis of their regressiveness. Moreover, the progressive character of the taxes will contribute to slowly but steadily shifting the terms of the debate, from *distributional fairness among states* to *distributional fairness among individuals*.

C) Which could be normatively sound and prudentially advisable taxes for the Union?

Thus, we are looking after taxes which comply with the two conditions abovementioned. This leaves us with several candidates which rank high in both normative and prudential terms. Two of them are a tax on savings income and some form of European corporate income tax.

As it has already been hinted, the income derived from savings has become de facto untaxed if the income is obtained in a jurisdiction other than that of residence of the taxpayer.¹⁴⁷ This is the result of a series of legal, economic and technological changes, among which the globalisation of financial markets and the *deep* deregulation of the movement of capitals within the Union.¹⁴⁸ However, the member states have committed themselves to introduce buffering mechanisms that would allow to regain the *actual* capacity

¹⁴⁵ Against, see Menéndez, *supra*, fn 54, chapter 5.

¹⁴⁶ Against a purely *prudential* understanding of the Communities, see of course Erik O. Eriksen and John E. Fossum: 'Post-National Integration' in Erik O. Eriksen and John E. Fossum, *Democracy in the European Union. Integration through deliberation?*(London, Routledge, 2000), pp.1-28.

¹⁴⁷ See Harry Huizinga and Gaëtan Nicodème, 'Are international deposits tax driven?', Economic Paper 152, June 2001, Brussels, Directorate General for Economic and Financial Affairs, European Commission (ECFIN/292/01-EN). At http://europa.eu.int/comm/economy_finance/publications/economic_papers/2001/ecp152en.pdf.

¹⁴⁸ See references in fn 102.

to tax savings income.¹⁴⁹ Automatic exchange of information among the tax administrations of the member states has been endorsed as the ultimate solution to the problem.¹⁵⁰

Modesty and Ambition could argue that the regained power to tax savings income should be granted to the Union, not to member states.¹⁵¹ Such a tax would rank high both in normative and prudential terms. First, its Europeanness is very visible. Savings income accrues to individuals thanks to a complex set of legal norms, most of which are actually decided at the European, not the national level. After all, such income accrues to people who make use of the free movement of capital (directly, or with the help of financial institutions). Moreover, it is very obvious that the actual capacity to tax such income depends on the problem-solving capacity of the Union. Only by means of coordinated European action it will be possible to recover control of this tax base. Second, it is well established that the better off one person is, the higher the percentage of income it derives from capital.¹⁵² A tax falling upon savings income, even if applied at a proportional rate, would be burdening the better off *more than proportionately*.

A second suitable tax is the corporate income tax. European integration has resulted in the definition at the European level of the basic legal framework through which markets are upheld. As was already argued, this implies that the national markets and the national communities of economic risk have been transcended *de facto*. Those very circumstances advise in favour of allocation part of the corporate income tax base to the Union. First, the Europeanness of the tax will be very visible. The normative framework which determines the constitution and operation of companies in Europe is heavily determined by Community law, even if national laws keep on playing a major role. Moreover, the single market is intended to foster that

¹⁴⁹ Already in the Preamble of Directive 88/361, full reference, *supra*, fn 94: “[A]dvantage should be taken of the period adopted for bringing this Directive into effect in order to enable the Commission to submit proposals designed to eliminate or reduce risks of distortion, tax evasion and tax avoidance resulting from the diversity of national systems for taxation and to permit the Council to take a position on such proposals”. The *saga* of proposed directives is considered in my “Taxing savings or savings Taxes”, forthcoming as Arena Working Paper.

¹⁵⁰ See references in fn 103.

¹⁵¹ Provisions could be made to calculate savings income as part of the total income to be declared in member states so as to avoid *breaking up* the progressive character of personal income taxes. A credit could be granted for the European taxes paid on account of the referred savings income.

¹⁵² There is a sizeable literature on the matter. For France, see the extremely enlightening Thomas Pikkety, *Les hauts revenus en France au XXe siècle. Inégalités et redistribution 1901-1998*, Paris, Grasset, 2001.

companies, big and small,¹⁵³ consider the whole territory of the Union as a single market. The correlation between site of constitution of the corporation and the actual place where its economic activities are developed becomes radically weaker. Second, corporate income taxation falls upon corporate profits. As it was the case with savings income, the higher the level of income of an individual is, the higher the proportion of income that derives from corporate dividends. Therefore, even if collected at proportional rates, corporate income taxation tends to have *progressive distributional effects*.¹⁵⁴

The actual allocation of the power to tax corporate income to the Communities has been considered several times.¹⁵⁵ The main rationale for that decision has been economic, though. Different national systems of corporate income taxation can be used in order to obtain similar economic results to those stemming from openly protectionist measures. At any rate, it might be proper to add that such is decision has started to be considered more seriously. The Commission has recently come to the conclusion that only the harmonisation of the national laws which determine tax bases would allow to eliminate the remaining tax obstacles to the economic freedoms inscribed in the Treaties.¹⁵⁶ This adds some further *feasibility* credit to the second tax option here suggested.

Conclusions

This paper has aimed at showing why the European Union should be granted a genuine power to tax. The argument was developed in several steps, which can be summarised as follows. First, it was shown that such the granting of a

¹⁵³ At the very least theoretically.

¹⁵⁴ Of course, I am aware of the whole literature on the shifting of the corporate income tax burden. But one can say that such literature is inconclusive. The fact that the decision whether to establish corporate headquarters in a given place is not uninfluenced by tax considerations might indicate that the shifting claims are somehow overemphasised.

¹⁵⁵ European Parliament, 'Interim Report of the Committee on Budgets on the Financing of the European Community', A3-0000/94, Ernesto Albi and E Corina, 'Corporate Tax as a Possible Fifth Own Community Resource : How Much Harmonisation is Necessary', study XIX/B1/9602 prepared for the Commission of the European Communities, DG-XIX, June 1997; Sylvainne Plasschaert: 'An EU Tax on Consolidated profits of multinational enterprises', European Taxation, 1997.

¹⁵⁶ See Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee, 'Towards an Internal Market without tax obstacles', of 23 October 2001, COM (2001) 582final, at pp.15ff and Commission Staff Working Paper, 'Company Taxation in the Internal Market', of 23 October 2001, COM (2001) 582 final, SEC (2001) 1681, at p.372: "Overall, it is clear that the Internal Market would benefit greatly from a common or harmonised base which permits effective cross border consolidation of losses".

power to tax to the European Communities is both *legally mandated* and *legally framed*. Member States agreed from the very inception of the Communities that the latter should become *financially autonomous*. In stark contrast to classical international organisations, or for that purpose, to the Articles of Confederation, the Communities were expected to acquire full taxing and spending powers. Moreover, Community law has determined the range of public goods which should be financed through the Community budget. Special attention was paid (in Section 3.A.a) to the affirmation of the principle of social and economic cohesion as one of the fundamental principles of Community law. Second, it was argued that the development of a genuine power to tax of the Communities is *normatively desirable*. The positive normative properties of a European power to tax were unfolded in two smaller steps (the modest and the ambitious cases of reform). The principle of *no public expenditure without taxation* was shown to require the financing of the present European budget through taxes. A proper determination of requirements of distributive justice in a complex political community were said to defend a larger European budget, aimed at the redistribution of economic resources *among* the citizens of the European Union. Third, the two cases of reform were said to be *prudentially advisable*. Redistributive taxation, was claimed, can be said to be the price of European civilisation, and at any rate, is a basic precondition for the successful consolidation of the Union as a political community, and for the proper integration of new members once enlargement to the East is fully effective. A summary look to the American case further shown that the creation of supranational institutions tends to lead to the establishment of central powers to tax. Those tend to be reinforced once the question of distributive fairness in the allocation of public burdens becomes a central one in the political agenda (as it was the case in the United States from, at the very least, the turn of the XXth century). Fourth, the two cases were shown to be *feasible*. Legal, normative and prudential criteria point to the (partial) transfer to the Union of the power to tax savings income and corporate income.

The association between national sovereignty and power to tax is still so strong that the arguments presented in this paper might still sound radical to many ears (especially, one must guess, to some ears across the Channel). But a proper look at facts, and a serious commitment to norms, proves that national sovereignty on tax matters is about to become a mere myth, and a perverse

one in many senses. To hold tight to unfeasible conceptions of feasibility is a bad strategy to enlighten practical reason.

TABLE 1
Ratios of national direct contributions before the first system of own resources

COUNTRY	EEC and Euroatom Administrative Budgets	Social Fund	Euroatom R&I	First Development Fund	Second Development Fund	Third Development Fund	EIB
Belgium	7.9	8.8	9.9	12.0	9.4	8.89	8.65
France	28	32	30	34.4	33.8	33.16	30
Germany	28	32	30	34.4	33.8	33.16	30
Italy	28	20	23	7.0	13.7	15.63	24
Luxembourg	0.2	0.2	0.2	0.2	0.3	0.27	7.15
Netherlands	7.9	7.9	6.9	12.0	9.0	8.89	0.2

Source: Isaac E. Druker, *Financing the European Communities*, Leyden, Sijthoff, 1975, p. 243

TABLE 2
Summary of the evolution of the public finances of the European Communities

Period	Budget	Unit of Contribution	Unit of Expenditure
1951-64	Fragmented	Member States; variable ratio in each sectorial budget	Member States/Individuals and legal persons
1964-69	Fragmented, but tendencies towards rationalisation (e.g. Merger Treaty)	Member States	Increasingly individuals and legal persons(CAP)
1969-88	Towards Unity; Role of the European Parliament in the forging of the budget	Individuals and legal persons(VAT, agricultural levies, customs duties)	Individuals/Legal Persons; Regions: Regional and Structural Funds
1988-93	Towards Unity; Role of the European Parliament in the forging of the budget	Individuals, legal persons; Member States back (fourth resource)	Regions: Regional and Structural Funds; Declining role of individuals in favour of legal persons in allocation of agricultural funds
1993-	Towards Unity; Role of the European Parliament in the forging of the budget	Member States (fourth resource); Decline of Individuals/Legal Persons	Regions: Regional, Structural and Cohesion Funds.

TABLE 3
Distribution of Monetary Income (Seigniorage) after 2007

MEMBER STATE	SHARE
Belgium	2,8658
Denmark	1,6709
Germany	24,4935
Greece	2,0564
Spain	8,8935
France	16,8337
Ireland	0,8496
Italy	14,9850
Luxembourg	0,1492
Netherlands	4,2780
Austria	2,3594
Portugal	1,9232
Finland	1,3970
Sweden	2,6537
United Kingdom	14,6811

On the assumption that all Member States will be participants in the third stage of Monetary Union.