Does the EU Need a Tax of Its Own?

The demand has been raised in various quarters recently that the EU should have a tax of its own. What are the reasons behind this demand? And what are the arguments of its opponents?

Michaele Schreyer*

The Own Resources System Needs Rethinking

Little public attention is commonly attributed to the ways the European Union gets its money and to the sources of the Union's finances. Only very recently has the public debate on the need for a "European tax" been reanimated by several European politicians in relation to the broader debate on the future of the European Union.

Thinking about the revenue side of Europe's budget, it appears clearly that in terms of autonomy, transparency and political responsibility, the system for the financing of the European Community has moved a long way from the objectives assigned to it by the founding fathers. While the original objective consisted in ensuring a high degree of autonomy of Community resources in line with the ambitions of an economically and politically integrated Community, this autonomy has eroded over time. It is therefore necessary to rethink the own resources system.

Autonomy of Financing

In 1970, with the first decision on own resources[1] the founding Member States followed up the Treaty mandate[2] by replacing the Member States' financial contributions by Community own resources.

Allocating the Communities own resources was intended to ensure that the European budget would have its own financing and not be dependent on financial contributions from Member States, like classical international organisations. The instrument comprised two elements: genuine own resources (customs duties) and receipts accruing from application of a uniform callrate to a harmonised VAT base.

Two major changes, however, occurred in the eighties. The first in 1984, when the Council adopted a corrective mechanism in favour of the United Kingdom, which is still in force today and which the UK authorities demanded after finding the UK's budgetary burden intolerable. The second change was in 1988 when the Council created a "fourth resource" based on GNP, which represents contributions from the national budgets to the European budget.

The GNP-based resource was originally intended to be an additional resource, which would be useful for resolving the financial problems facing the Community in the late eighties, and as being fairer than the VAT resource, as it was a better reflection of the Member States' capacity to contribute. In actual fact, the GNP resource has become the main source for financing the Community budget. As a financial transfer from the national budgets to the Community budget the "fourth resource" was debasing the very idea of own resources.

The current system has obvious advantages: it provides the Community with a secure and efficient source of finance, which balances the budget and has low costs in terms of administration.

However, if the situation continues to evolve as it has done since 1988, the trend being strengthened by the continuous dropping of customs duties as a result of an increasingly liberal trade policy, it will soon be found that the initial objective of financial autonomy has been abandoned and that the European Union budget is almost entirely financed by national contributions: in 2000 customs duties and agricultural duties,

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[1] 70/243/ECSC, EEC, Euratom: Council Decision of 21 April 1970 on the replacement of financial contributions from Member States by the Communities' own resources Official Journal L 094 , 28/04/1970 p. 0019.

[2] Article 269, paragraph 1, EC-Treaty stipulates: "Without prejudice to other revenue, the budget shall be financed wholly from own resources".

the so-called "traditional own resources", represented 15% of Community revenue, VAT receipts 38%, and the "fourth resource" based on GNP 42%. In comparison, in 1971, the customs and agricultural duties amounted to 55% of Community revenue. In 1988, the year of the introduction of the GNP-based resource, traditional own resources represented 28%, VAT receipts 57% and the fourth resource 10% of revenue. The overall trend, that has been strengthened by the Own Resource Decision of the European Council of Berlin 1999, can thus be summarised by the continuous decrease in importance of traditional own resources and VAT receipts, and the progressive increase in importance of the fourth resource. This trend translates into a lack of autonomy in European budgetary policy in relation to national budget policies.

Transparency of Financing

The current own resources system does not provide for a direct link between the citizens on the one hand and the European budget on the other and has become completely unintelligible to the non-expert at a time when Europe occupies an increasingly important place in everyday life. Decisions at European level have a real effect on economic activity and, although its budget is modest by comparison with those of the Member States, the Community's financial measures are also perceptible to citizens.

However, the different sources of financing on the one hand and the institutional rules related to the establishment of the budget on the other today are far too complex and responsibilities do not appear clearly. The own resources system must be restructured in order to increase transparency and make it possible for the European citizen to assess what he or she is contributing to "Europe".

Political Responsibility for Financing

When approving the budget, the European Parliament fixes the level of expenditure, but has no responsibility in raising the public money needed to finance it. In fact, the Council of Ministers, representing the Member States, retains the exclusive legislative power with regard to the financing of the budget.

This distribution of responsibilities is not without risks. The most important is the "disempowerment" of the European Parliament, the political representative of the citizens of the European Union. The European Parliament is thus the only democratically elected parliament without the right to decide on the revenue side of the budget.

In addition, for national parliaments the situation is somehow frustrating too. In the current system, they are involved in the decisions on the European budget only by ratifying the legislative acts on own resources. But then, year by year, they are forced to accept, this being a tied power without margin of manoeuvre, the transfer of funds from the national budget to the European budget without being able to debate how these contributions are used.

Moreover, in the present system, the concept of "fair returns" has a central role when it comes to designing policies at the European level. Today, when deciding on policies related to public expenditures, Member States often make their vote dependent on the aspect of their "returns". A new own resources system would shift the logic from a "fair return" objective towards a balancing between the burden for the taxpayer and the effects of the policy.

Ways Ahead for the Restructuring of the Own Resources

For the reasons mentioned above, the current system of financing European policies no longer lives up to the initial objectives and has serious flaws in terms of transparency and political accountability. The question of the reform and the redesign of the European Union's own resources is of course intrinsically linked to the democratic debate on the future of European integration.

Continuing the present trend towards a system of national contributions to the Community's budget stands, to some extent, in contradiction to deeper European integration. If we want a visible and politically responsible Europe, which is able to act effectively and which is closer to its citizens, a better definition of powers and responsibilities is essential. It is necessary to have a financing system which will give the Community effective financial autonomy.

What conditions should the future own resources thus satisfy?

Firstly, they must be sufficient to ensure budget balance and the financial autonomy of the Community. This of course does not mean that we have to find a resource that is itself capable of financing the entire budget. As is the case for all the Member States, it makes sense to have a system based on a number of resources whose characteristics are complementary, and whose shortfalls mutually offset each other.

Secondly, the allocation of new own resources to the Community can in no way be allowed to increase the tax burden. Above all, the Communities' financial

autonomy must not involve any increase in taxation. Just as the process of European integration goes hand in hand with a transfer of political powers from the Member States to the Community, the resources needed to finance these policies shall also be transferred to Europe at the same time. No reform, of course, will alter the principle of a balanced budget, enshrined in the Treaty,[3] and the prohibition of deficit spending.

Thirdly, the own resources must be recognisable and identifiable as such by the public. The public should know that a tax or parts of a tax they are paying is intended to finance "Europe". Without entering too far into the debate on which taxes could be candidates, one could think of taxes that are not connected to a certain national territory or the Member States.

The last condition to be fulfilled, and even if this might seem evident, is that own resources will always be collected by Member States. It is essential therefore to avoid own resources which would be extremely complicated to collect by the Member States and to manage and control if the Commission is to exercise its powers of control with limited resources.

Concluding Remarks

The debate on the own resources of the European Community and the reform of the own resources system is not new. It will always be a politically sensitive issue and thus remain subject to a unanimous decision of the Member States. It also seems obvious that any change in the own resources system must result from genuine negotiations between the Member States with the active participation of the European Commission and the European Parliament.

[3] Article 268, paragraph 3, EC-Treaty.

The objective to be achieved is more financial autonomy of the European Community as aimed for in the original Treaty provisions, in order to make its activities, and the budgetary consequences which arise, more transparent and more visible and to allow the European institutions to exercise their full political responsibility. Hence, political agreement must first be reached on the advantages of the enhanced financial autonomy of the European Union by a direct financing of the budget. Once agreement is reached on this principle, the appropriate resources for achieving this objective can be identified.

Thus, and to come back to the initial question, "Does the EU need a tax of its own?", I would argue that the EU needs a rethinking and a restructuring of the present own resource system in the direction of a more direct financing of the European budget by the taxpayer. This would not necessarily mean the creation of a new tax. There is also the possibility to transfer to the Union the power to dispose of the receipts of an existing tax or of parts of an existing tax. The aim should lie in increasing the transparency of the Community's own resources for the European taxpayer and in the democratisation, i.e. "parliamentarisation", of the own resources.

What we can rule out vigorously right now is the creation of additional sources of income. Thus, the design of a new resource will go hand in hand with the proportional reduction of the national contributions.

The European Commission will present a review of the own resources system to the European Parliament, the Member States and the general public at the latest in 2004. Before that, the European Council under the Belgian Council Presidency in Laeken in December 2001 might offer a good opportunity to anchor the issue of the future of own resources in the negotiation mandate for the "post-Nice process" on the future of the European Union.

Marc Suhrcke

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More Fairness, Democracy and Transparency!

In June of this year Belgium's Prime Minister Guy Verhofstadt, in his capacity as current President of the European Union, kicked off the discussion on reform of the financial system of the European Union. His demand for a "European tax" unleashed a controversial debate at both the European and national levels. The reason behind his demand is not a new one. The highly criticised, old-fashioned financial system, in its current form, is seen as both incomprehensible and unsuitable for the future political, economic and financial development of the European Union.

In the first decades of the European Community's existence, the Community's annual budget was financed exclusively from contributions made by the Member States. In 1970 Member States decided to change that system by introducing what we call "own financial income" for the European Union. The different sources of income or revenues, called "own resources", were derived from customs duties and agricultural levies, hence the term "traditional own resources". Own resources based on a common assessment system of value-added tax (VAT) were also introduced.

However, in the beginning, only traditional own resources brought real income, since all Member States had difficulties with the establishment of a common VAT system and consequently with the definition of a common assessment basis. The economic decline in the second half of the seventies, which lasted until the middle of the 1980s, led to a loss of income from VAT. The recession in the world economy and the consequent reduction in revenues to the Council, representing the Member States, were not the only factors responsible for this reduction in VAT revenues.

Since Robert Schuman's declaration of 1950 the structure of the European Union has changed completely. There has been a profound change in the nature of revenue that is derived by the EU. The first enlargement waves in the 1970s and the 1980s, the establishment of the Single Market in 1993 and many agreements and contracts with non-member states of the European Union have reduced customs duties and agricultural levies by simplifying access to the common market. Because of this Member States agreed in 1984 on the introduction of an additional own resources type, based on the gross national product (GNP) of the individual member states.

Regardless of what own resource they derive from, the contributions of the Member States should reflect the economic strength of the individual Member States. This should also be based on the gross national product per capita thereby leading to a fair and balanced burden for all. However, the opposite is the case.

The system is only fair in principle. In reality, it applies to only 14 out of 15 Member States, and even that is not entirely the case. In 1984 the then British Prime Minister, Margaret Thatcher, negotiated a rebate – the so-called "abatement" – for the United Kingdom. The rebate returns to the UK two thirds of the difference between its payments to Brussels from VAT and the money it receives back in EU spending. Since its introduction, the abatement has saved the UK and the British taxpayer £ 20 billion or more than € 35,000,000,000. The remaining 14 Member States have to pay the bill.

And if there is no change in the system now, this issue should be addressed going forward. The "Iron Lady" made sure that the rebate was enshrined in the Treaty of the EU. To revoke this, a unanimous decision must be taken by the Council of the European Union but so far the UK has steadfastly refused to negotiate its rebate.

Current Situation

In a further development of the system, the Community has specified an upper limit, also called a "ceiling", since 1988 for financing the European Union's expenditure. The ceiling is valid for the duration of a financial perspective (such as the Agenda 2000) which is currently seven years.

In the budget for the year 2001 the GNP own resources amount to about half (47.54%) of all incomes, the value added tax share is 36.79% and the traditional own resources are only 15.67%. The

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remaining amount is collected via miscellaneous Community taxes, levies and dues, a revenue accruing from the administrative operation of the institutions, borrowing and lending operations.

Agenda 2000, which was adopted by the Member States of the European Union at the European Council in Berlin 1999, foresees a ceiling to the expenditure of 1.27% of the GNP of the European Union for the period 2000 - 2006, already providing resources for enlargement. Presently, this ceiling is not exhausted by the EU budget. On the contrary: the relative expenditure volume has been declining for years, from 1.20% in the year 1999 through 1.11% in the year 2000 to 1.09% in the budget 2001. Every euro which the European Commission cannot spend is transferred back to the Member States. Since the budgetary year 2000 Member States have received money back to the value of almost € 10 billion or 10.7% of the total budget.

Furthermore the Community is not allowed to take out any loans, so there are no costs for interest rates or repayments. The widely spread public opinion that the European Union is getting more and more expensive for its Member States' budgets and taxpayers is, at a closer look, completely wrong.

So far, so good. The logical question, which might occupy the reader by now, all things being equal is, if everything is going so well, with the exception of the British rebate, why should there be a complete change in the income system of the European Union? Why are so many people demanding the introduction of a new tax, a European tax? The answer is twofold: the current financial system is neither transparent nor democratic.

One matter should be clear. Just as the European Union did not conceive its current system and form in one day, this article does not ask for the creation of a new financial system which is theoretically conclusive, transparent and democratic to be put into practice by tomorrow.

However, the current financing of the policies of the EU are hardly understood by the Finance Ministers of the Member States or those Members of the European Parliament not dealing with the budget, who should be experts on the subject, not to mention the citizens of Europe. The present mixture of value-added-tax resources, GNP own resources, agricultural levies and customs duties returns is no longer understandable and thus provides for a "natural" distrust. The citizens of Europe cannot understand how much money they are contributing to the Community's budget. A clear and visible tax, which would flow directly to the European Union, would therefore be a signal of great importance and might pave the road for a Europe of the citizens.

For nearly ten years the European Parliament has been demanding a visible and understandable financial system. This request is old, but today more valid than ever. Europe would become more plausible and transparent if the citizens could see which part of their taxes is used for the implementation of the policies of the European Union.

Possible Solutions

Finally, it is now time for us to take the necessary steps which bring us closer to this goal. A first and simple step would be the imposition of a common European tax, which flows totally or partly to the Community's budget. One current possibility would be the introduction of an EU internet tax, which is currently being negotiated by the Finance Ministers of the European Union. For internet services from a third country value-added tax is to be paid in the near future in the same way as for a service of a company within the Union. Another possibility could be the tax on interests which is also being debated presently.

Let me make one thing clear: I am not asking for the introduction of any new taxes and or any further contributions by taxpayers. This would lead to a higher burden for the citizens of Europe. Existing taxes could be turned into EU taxes. Such a proposal represents simply a restructuring of the incomes and does not serve as a basis for an increased expenditure policy. A direct tax would result in a reduction of the own resources previously raised. The aspect of cost neutrality for taxpayers is a crucial element of the proposal.

Apart from the lack of transparency for citizens, the present financial architecture also lacks democratic control by the European Parliament. Regarding expenditure of the budget, democratic control is ensured by the interaction of the European Parliament and Council of Ministers, together representing the so-called "budgetary authority". The income side however is determined unilaterally only by the Council of Ministers. The Council even refuses to talk with the parliamentarians about the incomes.

The European Parliament is refused a right which all national parliaments have. It is essential to repair this deficit of democracy. The responsibilities for all expenditure and all incomes belong together; the two institutions have to justify their political decisions and resulting financial implications together. The use and the imposition of taxes must be co-decided by the

institution which is elected directly by the people. The European Parliament must therefore get co-decision on the income side; it needs the full budgetary rights.

The present European debate is a debate about principles, to which above all the German Federal President, Johannes Rau, and Chancellor Gerhard Schröder have made important contributions. It offers a great opportunity at the right time to tackle the reform of own resources before the beginning of the next financial period in 2007. Part of a future Europe is not only a clear political delimitation of competences, but also an own financial source for the European Union. With the introduction of an understandable financing of its policies the European Union can take a large step towards the great goal of a Europe of the citizens.

Leif Mutén*

The Case for an EU Tax Is Not Convincing

The EU budget is financed basically in three ways: all customs revenues, a percentage of the VAT base, and member country contributions. Recently, proposals have been made for a new order, under which the EU would levy a tax of its own, either on the VAT base or in some other form. In this paper, some arguments will be presented in support of and – mainly – against these proposals. It should be noted that nothing is said about the issue in the European Commission report "Tax Policy in the European Union".[1]

The Need for a New Tax

Do we need a new EU tax? The basic answer must be no. The EU budget could be trimmed, or restructured, by the fundamental revision of the Common Agricultural Policy that we have to undertake, anyhow, before the Union is widened to include a number of new members. The VAT *base* could be used to a greater extent as a base, if needed – the VAT *revenue* could not, since it is derived from different tax rates and exemption patterns. The member countries cannot possibly see even a somewhat increased contribution to Brussels as such an important burden on their budgets as to motivate drastic changes.

One argument in favour of the EU tax is the federalist idea. The Union, if seen as a federation, should be financed not by contributions from each member state, but directly by taxes paid to the federation by its citizens (or rather its residents). To this argument, let it first be said that the federalist approach is not taken by all European governments, let alone by all Europeans. It is a rather remote idea that citizens of the member countries of the EU would adopt a more positive attitude to the federalist ideas by being exposed to a new tax, based on federalist principles. The development of Europe might well in the long run go towards a federalist European Union. The road to this state of affairs will be a thorny one, however, and even more so, if a new tax is used as an argument for wider acceptance of federalism.

Another argument is that it is unfortunate that member states – as many or all regrettably now do – make up their accounts with the EU and conclude that some member states are winners and others losers, the former ones receiving more from Brussels than they pay, the latter less.

There is a good deal of sense in this approach to the new tax issue. Our chances of building a real community spirit in the EU do not improve by the showing of figures for winners and losers. The risk, when the EU is expanded, of the new members being winners and some present winners turning out to be losers is certainly not attractive. If an EU tax could be fashioned so as not to allow the computation of each country's contribution, optimists might see the end of the winner-loser comparisons and hence the removal of one of the mental obstacles to the development of a community spirit.

It is, however, hard to envisage an EU tax collected so as not to allow national statistics showing the outcome for each member country. The administration of an EU tax would for obvious reasons be in the hands of the national tax authorities. Building up a new administration for collecting an EU tax would squander the European taxpayers' money. Establishing an EU tax administration for the purpose of collecting both EU tax and some or all national taxes would be a development in direct conflict with the subsidiarity principle.

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[1] Com (2001)260 final 23 May, 2001.

Even if there were an EU tax administration, it would have to establish its activities in each country in a fashion that would make it unrealistic to expect that the collection would not be accounted for according to country.

Another argument for an EU tax could be that the present financing of the EU budget rests too much on taxes on goods and services. This criticism is not very well founded, however. First of all, whereas the VAT share and the customs revenue fall under this label, the member states are free to decide for themselves from which revenue sources contributions are paid. Moreover, the tax structure being within the realm of each member country's sovereignty, member countries can decide their tax structure for themselves, taking into account, if they wish, the part of it they have to send over to Brussels. For instance, any member is free to establish that it wants a VAT rate at the minimum allowed by the EU. If the EU VAT contribution rate were raised, such a country would still be perfectly free to stick to the 15 per cent VAT rate and look for compensating revenue among other taxes.

Even if the EU tried to meddle with the tax structures of member countries, its success in doing so would be doubtful. The structural influence of any form of EU tax could be eliminated by a reduction of the corresponding national tax. If the EU felt that an income tax would be the best instrument to collect revenue for the EU budget, member countries would be free to reduce their national income taxes correspondingly and increase their national taxes on some other base instead. Of course, the EU could choose to impose a tax of a kind most member countries do not have in their fiscal arsenal. For instance a Tobin tax (on foreign exchange dealings) or a net wealth tax (on the net wealth of individuals and possibly corporate bodies) would not be of a kind that all or most countries would have as a national tax. Accordingly, in these cases no similar national tax could be reduced to compensate for the EU tax. The prospects of the EU tax taking such a form are not at all promising, however. On the contrary, imposing as an EU tax a levy that has not been generally accepted, and in several member countries indeed abolished, would politically be the most unrealistic approach conceivable.

The Form of a New Tax

The proposals for a new EU tax are not as precise as to allow a statement on what kind of tax its proponents would like to see imposed. Indeed, it seems as if that issue is more or less open. Thus, no chances are spoiled to gain support from different circles with different purposes of the tax in mind.

Perhaps the most common version of the EU tax is a VAT. The VAT is already greatly harmonised. A totally harmonised tax base already exists for the computation of the VAT-based contributions to the EU budget. The idea of a separate EU VAT applied openly on the basis of the general, harmonised VAT base is not attractive if we apply the ideal of subsidiarity. The latter implies that national VAT rates are allowed to vary, and that in some cases zero-rating is still accepted even for domestic supplies of some products. Two VAT systems applied on the same sales and deliveries are impractical. Full harmonisation to make the EU VAT and the national VAT apply to the same base would go very far along the way of harmonisation.

Another idea would be to impose an income tax earmarked for the EU. Such a tax could be a tax on the income of individuals, although it should be noted that not all countries apply the strict difference Germans observe between income tax on individuals and corporate tax on legal entities. The EU tax would have to be levied on a base uniformly defined throughout the EU. In this regard, a quick look at the tax laws of the member countries is enough to show that what is taxable income (and taxable corporate profits) is defined differently in all national systems. If the member states could arrive at a total harmonisation of their tax laws, however, a common definition of taxable income could in principle be achieved.

Without such a harmonisation, the EU income tax would have to be imposed on a different tax base than the national income tax. The EU tax could still ride piggyback on the local assessments, but only after adjustments to make the assessed tax base conform to the EU tax statute as adopted. Questions would have to be solved such as the taxation of husbands and wives, the taxation of incomes of children staying with their parents, the taxation of dividends, and the compatibility of the EU tax with the dual tax systems applied in some member countries. In as much as the tax would apply to profits, their computation would have to be unified. As long as there are member states not using the euro, converting profits into euro is another problem, and income elements affected by relations with the world outside the EU would also have to be dealt with in a uniform fashion. The list would be just too long. There is little reason to expect that the harmonisation programme that has developed at a snail's pace during the existence of the EU could suddenly fall into place once the need is

perceived to facilitate the collection of an EU income tax with a piggyback system.

The alternative to a harmonised EU income (and corporation) tax would be a separate EU tax, following a different system of rules. If the same national tax administrations were used for both the EU tax and the national tax, the application of a parallel system would be an administrative complication. The separate administration of the EU tax would be expensive. Compliance costs for taxpayers would be considerable, if they could not file their EU tax returns with the same tax authority as their national tax returns. Compliance costs would be high, if taxpayers had to present their figures organised in different ways depending on which tax they were concerned with, and this even if the same national tax authority received the returns.

Perhaps the strongest argument against an EU income tax is one brought forward by the Commission itself in the report mentioned at the beginning. The tax on labour incomes in the EU is already taking too large a share, and what is needed is not more income tax and social security tax on income from employment, but rather less.

The EU income tax should conceivably be directed to income from capital as well as business income and income from employment. Yet, the efforts of ECOFIN and the Commission to make the taxation of interest income effective, and the recognition of the magnitude of the tax haven problem, make it difficult to see an EU tax as being helpful in solving that problem. It would rather be the opposite.

Another way of imposing an EU tax would be an application of "green taxes" such as taxes on emissions, fuels, electricity, garbage disposal, pesticides etc.; the list is endless. The fundamental problem with these taxes is that if their intention has to do with environment protection, complete success would be one where no tax is collected. If the purpose of the EU tax is revenue collection, it is hard to see the tax being given a form that would be the best one to keep emissions down and the environment clean. Moreover, an EU tax on emissions etc. would meet with considerable problems in reconciling the interest of industry to stay competitive and that of the EU to collect sufficient revenue.

A rather common interpretation of the EU tax idea is for the tax to be a Tobin tax. The original idea of Tobin's was certainly not the prospect of a revenue-raiser for the EU. The American economist saw his tax as a means of putting a break to international speculation in currencies. The idea was to put a small turnover levy on international exchange movements, thus making short-term speculation in currency rate movements less profitable.

It is difficult to see this idea applied in the real world. We might leave aside the fundamental critical point, whether speculation is good or bad. Not even that point is self-evident. We should also take note of the fact that between 12 of the present 15 member states, the euro has made the potential Tobin tax base disappear. The potential base consists of transactions outside the euro area.

If we go to the practical side, critics have pointed out that much of the foreign exchange speculation could be moved inside the national borders by domestic trade in financial instruments. Such trade would not be affected by the Tobin tax. Another argument against the tax is that it would have to be general and world-wide to be effective. The likelihood that the whole world would join in is remote indeed. Finally, just as with the green taxes, if the tax were effective in choking speculative trade, it would be less than effective in collecting revenue for the EU.

Above, we mentioned that even a wealth tax could be considered in the context of the proposed EU taxation. The depressing fact is, however, that experiences with wealth taxes have been bad and the taxes abolished in a number of European countries earlier applying them. The only country to develop a wealth tax in recent years is France, and that tax is extremely limited to the greatest fortunes. The main problems with wealth taxes are two: one valuation, the other the proper treatment and definition of business property. Too unfair assessments of real property made the German constitutional court declare the German wealth tax unconstitutional. Exemptions for shareholdings of billionaires have made the same tax a laughing stock in Sweden.

Conclusion

In these few pages it has been suggested that the EU tax is not needed. Different forms it could take have been indicated, and it has been shown that whatever the form chosen, the complications would be great and the compliance costs considerable.

With all these strong arguments against the EU tax, and given the sad fact that most taxes are unpopular from the outset, the case for an EU tax is not convincing. Support for the EU among the EU citizens is not strong enough to be played around with. A tax that would weaken this support would be an expensive measure indeed.

Rolf Caesar*

An EU Tax? – Not a Good Idea

The idea that the EU should be given the right to raise its own taxes is not new at all. In particular, representatives of the European Parliament and the European Commission have repeatedly brought up such suggestions, and some economists have supported them as well at least for an EU in the final stage of a political union. However, two years ago it was explicitly stated in the Agenda 2000 that for the foreseeable future there was no need for such a tax and that the member states did not seem to be prepared to grant more tax competence to the European level. Taking this into account, it seems rather surprising that the debate on an EU tax has come up again now. The suspicion grows that this might have something to do with the growing concerns about EU eastern enlargement and, in particular, with the fiscal burdens expected in this context.

From public choice theory it is known that politicians, and bureaucrats as well, have an immanent tendency to increase budget revenues in order to finance additional expenditures. However, the present proponents of the EU tax idea have explicitly affirmed that this was not their intention and that the limit of 1.27 per cent of EU GDP should not be questioned until 2006. Instead, other arguments are raised. In particular, it is said that an EU tax would provide a higher transparency of EU financing for the taxpayer as he/she would then know what he/she was paying for the Community. In addition, it is argued that more efficient budget decisions at the EU level could be achieved if the European Parliament and/or the European Council had to vote not only on expenditures but also, and simultaneously, on revenues as well. In this perspective, an EU tax is regarded as a possible contribution to more transparency and rationality in European budget affairs. Furthermore, some proponents – like EU Commissioner Michaele Schreyer – believe that an EU tax might provide a solution for the ongoing debate on "net contributors to" and "net receivers from" the EU budget. Finally, it is argued in a more general sense that a European Community with an expanding scope of responsibilities and functions would need a tax competence independent of the national member states.

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More Transparency via an EU Tax?

Of course, the present system of EU financing is fairly complicated and certainly not transparent for European citizens. At best, the "man in the street" may have a vague idea of how much his country is contributing as a "net payer" to the EU budget. But probably he has neither a correct perception of the real size of the EU budget nor has he ever heard of the four types of "own resources" of the EU. Moreover, he would be unable to understand why the two most important of these alleged "own resources" – i.e. the value added tax component and the GDP component – are in fact only fiscal contributions by the member states' central governments. Hence, there is no doubt that more information could create a better understanding of European fiscal problems and maybe help to reduce the often quoted Euro-scepticism among the public.

However, to achieve this it is not necessary to transfer to the EU the right to raise its own taxes. Firstly, the indisputable deficits of transparency with respect to EU expenditure decisions in general, and EU agricultural and structural policies in particular, could and should be reduced by a reform of the EU policy-making process and by reforms of the respective policy fields; the revenue side has little to do with these problems. Secondly, the confusing and intransparent system of four different revenue sources could be simplified by reducing the number of revenue sources without introducing an EU tax. For example, it is imaginable that the EU should simply receive – apart from import duties – GDP-oriented contributions from the member states; this would render superfluous the complicated calculation of the VAT-based "own resources". Thirdly, it would be easy to make the taxpayer feel the true burden from the EU budget within the present system of contributions. It would only be necessary to convert a country's contribution to a surcharge on a national tax (to be chosen by the national government) and to declare the respective percentage openly to the taxpayer. In principle, any tax could be considered but probably the VAT (or the national income tax) would be the most appropriate one. To sum up, there is certainly a need for more transparency concerning the EU budget, but the question of an EU tax is an entirely different one.

More Efficiency in Budget Decisions?

The introduction of a widened EU competence in the field of taxation is also justified by the efficiency argument quoted above that those institutions which decide on expenditures should simultaneously vote on revenues as well. The theoretical basis of this argument is the principle of "fiscal equivalence" familiar from the theory of fiscal federalism. It demands that those who benefit from a public good and those who decide on the amount and the financing of this good should be identical. The present contribution system of the EU is regarded as being in contradiction to this principle because the decisions of the European Parliament and the European Council on expenditures are separated from the fundamental decisions concerning EU revenue limits. As a consequence, an incentive for an inefficient expansion of the budget is created as politicians calculate the political benefits of expenditure programmes but not the political costs of the tax burden resulting from these programmes. Tax competence for the EU could help to reduce such inefficiencies.[1]

Now it is certainly true that many examples can be found of inefficiencies in the field of EU expenditures. This applies particularly to the CAP and the structural funds. But it is highly doubtful that an EU tax would be a factor enhancing budget discipline. Firstly, when looking at political reality, there is little reason to think that the European Parliament would behave in a more disciplined way if it had the power to tax. Secondly, there is no effective democratic control of the European Parliament in the present political system; in fact, European voters have practically no means of sanctioning EU policy-makers for "bad" budget decisions. It is highly questionable whether the tax decisions by such a parliament could be accepted as being really democratic. Thirdly, according to the supporters of a "competitive federalism", a central tax competence for the EU would suspend the disciplining effects attributed to tax competition and create a "taxation cartel" instead. This argument would apply even more if the public sector in general, and the EU in particular, is regarded from a "Leviathan" point of view.

The "Net Positions" Debate

The hope expressed by Ms. Schreyer that an EU tax could put an end to the debate on the "net positions" of EU member countries does not seem very convincing. In the present EU budget, the redistributing effects between the member states result mainly from the structure of expenditures and not from the composition of revenues. Hence, a restructuring of the revenue side would not change the underlying causes of the positions of "net contributors" or "net receivers". For instance, the contributions of German taxpayers to Brussels could continue to be confronted with the flows from the EU budget to German recipients.

With an EU tax, the transparency of redistribution would probably be reduced. But this should not be seen as an advantage compared to the existing system.[2] Intransparent redistribution tends to increase the risks of moral hazard and possible inefficiencies resulting from this behaviour. In addition, less clearness on the redistributing effects of the budget could be regarded as a contradiction to the declared intention of EU policy-makers to create a transparent and citizen-oriented Community. Instead, the only effective way to finish off the "net positions" debate is a fundamental reorientation of EU budget expenditures. In sum, this would mean reducing the weight of the CAP and the structural policies (or even "renationalising" these policies) and concentrating instead on the provision of EU-wide public goods.

New Responsibilities for the EU?

Leaving aside such public choice arguments for a moment, the justification of an EU tax also seems highly doubtful from a welfare-maximising viewpoint. On the basis of the theory of fiscal federalism, there are mainly three possible arguments for transferring a tax competence to the central level, i.e. in the European case, to the EU.[3]

Firstly, the equivalence argument already mentioned suggests a European tax in order to finance EU-wide public goods. However, the present activities of the Community cannot be characterised as the provision of public goods but rather as (at least in their majority) a system of redistribution between member states; moreover, even if the Community were to provide public goods to a greater extent in the future, the postulate of fiscal equivalence could equally be fulfilled by a system of fiscal contributions.

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[1] Cf. D. Biehl: Die Reform der EG-Finanzverfassung aus der Sicht einer ökonomischen Theorie des Föderalismus, in: M.E. Streit (ed.): Wirtschaftspolitik zwischen ökonomischer und politischer Realität, Wiesbaden 1988, pp. 63-83.

[2] Cf. F. Heinemann: Europäische Finanzverfassung: Zwischen Umverteilung und Effizienz, in: R. Ohr, Th. Theurl (eds.): Kompendium Europäische Wirtschaftspolitik,, Munich 2001, pp. 231-232.

[3] For details, cf. P.B. Spahn: The Community Budget for an Economic and Monetary Union, Houndsmill et al. 1993; and R. Caesar: Zur Reform des Einnahmesystems der Europäischen Union, in: W. Zohlnhöfer (ed.): Europa auf dem Wege zur politischen Union?, Berlin 1996, pp. 145- 173.

A second approach starts from the instrumental character of taxes to achieve economic goals. An EU tax might thus be advocated if the EU were given explicit responsibility either for new allocative purposes, or the task of personal distribution, or for fiscal stabilisation. However, these arguments apply to the EU in its present state at best to a very limited extent. The Community performs considerable interregional redistributing activities, but it has no functions for personal redistribution; whereas a policy of personal redistribution might well suggest the use of taxes (mainly personal income tax), there is no economic reason why transfers between countries, or regions, should be financed by a general tax and not by intergovernmental fiscal contributions. With respect to stabilisation policy, opinions are quite ambiguous as to whether the EU ought to perform an explicit function in this policy field. Finally, the "instrumental approach" might make sense with regard to some allocative functions, such as environmental policy. In fact, the Community is already active in this area; however, if an EU environmental tax were justified for environmental reasons, then it could not at the same time be a solid basis for the financing of the Community.

Finally, a third argument refers to the case of a differing interregional distribution of the tax base, which suggests transferring such a tax to the central government level. This argument is particularly valid for import duties which, according to fiscal federalism theory, should flow to the central budget. However, this already happens in the EU. Thus it cannot provide an additional argument for an EU tax.

Altogether, welfare theory does not provide convincing arguments in favour of an extended tax competence for the European Community. Rather, it suggests that the existing mixed system which combines EU revenue competence for import duties with contributions from member states, is quite appropriate for the EU in its present state of political integration.

The Political Economy Aspect

This position can be supported when taking into account the dimension of political economy. To give the EU its own power to tax would entail a considerable softening of the budget constraint. Contrary to that, the financing of the EU budget by fiscal contributions reduces the financial scope of EU political actors. From the viewpoint of the "Leviathan theory", this means that a contribution system is better suited to restrict the Leviathan and to prevent him from exploiting the taxpayer. In the words of Brennan and Buchanan,[4] the allotment of tax competence to the European level in combination with an extended system of fiscal transfers from the European to the national level would have to be interpreted as some sort of an "institutionalised tax cartel". Keeping the existing tax pluralism within the EU is the best way to constrain the national Leviathan governments via tax competition and to adapt national tax systems to the differing preferences of taxpayers, and thus to realise the principle of "fiscal equivalence".

Altogether, there is no need for an EU tax. From a welfare point of view as well as from a political economy point of view the further financing of the Community by member states' contributions is much preferable to an extended EU tax power. Even the first step in this direction would be risky as it would set the stage for new desires by both the European Parliament and the European Commission. There is no doubt that EU eastern enlargement is a perfect opportunity for such increasing demands because an enlargement will unavoidably involve serious conflicts not only between the old and the new EU members but among the present EU countries as well. In such situations of conflict politicians at both the European and the national level will probably be inclined to follow the politically easier path of increasing taxes instead of cutting expenditures. And it might even be a temptation for national politicians to blame Brussels for the tax increases – in fact a very comfortable excuse.

As a matter of course, the proponents of an EU tax swear that such a tax would not increase the total tax burden. This would require that national taxes be reduced by the amount of the additional EU tax revenues. However, looking at historical experience, this is not particularly realistic. It can, rather, be expected that national politicians would use the tax relief (at least partly) either for a reduction of national fiscal deficits or for additional expenditures. Moreover, in a federal state like Germany it is difficult to imagine that the Federal and Länder governments would agree to resign part of their tax legislation power (e.g. on VAT) in favour of the EU. And at the EU level, the overdue scrutiny and further reform of the CAP and the structural funds would probably be slowed down. Therefore from the taxpayer's standpoint the verdict on the EU tax idea should be: "These things must be nipped in the bud!"

[4] G. Brennan, J. Buchanan: The Power to Tax, London et al. 1980.