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European Taxes and Fiscal Justice: Citizens' Support and Lessons from the US*

by

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Abstract

By demonstrating the importance of the own source of EU revenue, rather than focusing solely on the size of its budget, we can understand that financing the EU is not a 'zero-sum' game. Therefore, we use the term 'fiscalization'[I] which implies the power to tax, rather than ambiguous terms such as 'Eurozone budget'. History of federations, such as the US, teaches us that some types of taxes can only be effectively - and justly - levied by the highest level of government, the revenue from which could then be used for the common goods. Importantly, our data, based on YouGov survey conducted in 11 European countries, shows that the citizens support the introduction of European taxes, such a tax on large internet companies, which could reinstall the tax justice, provide more revenues for delivering EU-wide common goods and to make the Economic and Monetary Union more resilient.

Key-words

comparative federalism; Riker; fiscal union; EU taxation; US-EU comparison; fiscal justice

1. Introduction

Despite many reforms undertaken in the last decade and calls to establish some kind of a fiscal union[II], the EU is yet to come up with a solution to permanently address the weaknesses of Eurozone, i.e. the lack of resilience of the Economic and Monetary Union (EMU). One of the perceived flaws is its weak fiscal power or budget capacity. This is, however, as much an economic and monetary flaw as a political flaw. The gap between the expectations the EU creates and the means it has to address them undermines its social legitimacy. In addition, the way the EU collects the revenues that support its budget capacity promotes a perverse zero sum understanding of European integration, instead of highlighting its added value.

In this context, it is perhaps worth to take a closer look both at how another fiscal union was created, which emerged as a result of a sovereign debt crisis of its states and at what exactly EU citizens think of how the European Union funds (and ought to fund) itself. In order to do that, we will briefly present the fiscal history of the early US, followed by the analysis of a survey data on the citizens' preferences towards European budget capacity and power to tax, and the lessons for the EU. The lessons to be taken from both will be particularly important in the context of the current plans to introduce new own resources necessary to support the pandemic EU recovery package.

Let us start with a quotation from Alexander Hamilton, one of the Framers of the US Constitution and the father of the American fiscal union: *"Sir, if we have national objects to pursue, we must have national revenues."*[III] We argue that in a similar vein, if we have European objectives, we should have European revenues. The federal power to tax was the most important feature of the US Constitution[IV] and the lack of such a tax power, that is - the ability of a federal government to raise revenues from its own sources - was the main factor threatening the viability of the American Union and is now EU's "institutional weakness" (Moravcsik 2001, p. 169).

In a classical fiscal union, the federal government has the power to tax, but not the power to influence the budget of the states, as is the case with the EU since 2011. A usual explanation (and argument for many) for the current limits on the EU powers to tax is to prevent it from becoming a genuine federal union. But the paradox is that the current situation leads, in a significant way, to impose stronger limits on the fiscal sovereignty of its member states than it would be possible in the US. For instance, the European Semester - a name for an annual cycle of EU budgetary and economic surveillance - obliges the governments of the Euro Area member states to submit their budgets for the European Commission's approval every year in October, even before they are sent to their national parliaments. By not agreeing to give the EU tax sovereignty, member states have deprived the EU from the automatic financial stabilisers necessary to smooth asymmetric shocks within the EMU and have, instead, given it a substantial (even if, doubtfully, really effective) impact on the national budgets, significantly limiting their own budgetary sovereignty (cf. Miklin et al. 2021).

2. The American example

The US is a multilevel political system to which the EU is often compared (see, e.g., Egan 2015; Elazar 2001; Fabbrini 2007, 2017; Freudlsperger 2020; Gaspar 2015; Genschel and Jachtenfuchs 2011; Hallerberg 2006, 2013; Henning and Kessler 2012; Hinarejos 2013; Schelkle 2017; Wozniakowski 2018). The point of comparison is not to say that the destiny of Europe is a federation. Rather, it is to analyse how mechanisms of economic and political integration played out between the American states, because their multi-level nature and degree of interdependence was in principle similar to the nature of mechanisms governing economic and social integration in Europe. The point is not to copy American solutions but to learn from how they have addressed multi-level governance as a consequence of economic and social interdependence. The lessons may be as much about their mistakes as about their successes and always mindful of the different contexts. One has much to learn even when one does not copy.

One of such issues is the complex issue of taxation in a multilevel system of government, economically interdependent, and the connected issue of financing the Union. Interestingly, there was a period, lasting over a decade, in the American history where both of those issues - taxation and Union's budget - resembled their equivalents in the EU. Namely, in the period between the Declaration of Independence in 1776 (and drafting of the first US constitution a year later - the Articles of Confederation) and the ratification of the US Constitution in 1789. During such period the budget of the Confederation was based on the contributions from the states.[V] The Union did not have the power to tax, as this power was an exclusive competence of the states, similarly to the tax and budgetary situation of the EU today.

As a consequence, the expenditures that should be financed by the Union, such as the military (Americans waged an expensive war against Britain until 1783), were *de facto* financed by the individual states who had to take up large debts for this purpose. The states who fought a war on their territory held the most of the debt, and some of them decided to pay it off by imposing direct taxation on population. This resulted in tax revolts, with the Shays's Rebellion of 1786/87 in Massachusetts as the most famous example. Those revolts were an existential threat to the new Union and helped to convince the elites from almost all the states that they needed to create a stronger Union or risk disintegration. Thus, another revolution followed, this time - a revolution in favour of government (Edling 2003). The elites gathered in the Constitutional Convention in Philadelphia decided to create a strong Union with a power to tax as its most important prerogative. And later on, this drafted Constitution was ratified by nearly all the states through democratically elected special state conventions.

Why did people who had fought a long tax-motivated war with a foreign power (hence the famous "no taxation without representation") and afterwards rebelled against taxation levied by their state governments, a few years later supported the idea of giving the federal government - which was much more distant than the state governments and almost as distant as the British government - a power to tax? In fact, this was a very rational, if paradoxical, decision to take. The explanation lays in the nature of different types of taxes. In a nutshell, the states could impose two types: direct taxes on income and indirect taxes, usually in a form of tariffs on imported goods. Because the states with large ports, such as New York or Boston, were competing with each other, there was a limit in the tariff rates that could be imposed - otherwise merchants would transport their goods to another port or would try to smuggle them. People were not so mobile as merchants and goods. As a consequence, there was very little they could do to escape the direct taxes on income that many states imposed on them in order to pay back the war debts. The only way to lower the tax burden imposed on the people resulting from direct taxes at the level of the states would be to impose a different type of taxes, only possible at level beyond the state, the federal level. Paradoxically, in order to pay less taxes, citizens had to agree to a new tax power, a federal tax power that could effectively be directed towards the merchants and their income.

The way to make the merchants pay their fair share and to increase the revenue from that source was to shift the power to impose tariffs to the federal level. This would allow a uniform tariff rate to be imposed throughout the states and eliminate tax competition in that respect. At the same time, it allowed the Union to increase revenue and pay off states wartime debt, subsequently freeing them from that liability. The result was a surge of tariff revenue. Once taken over by the Union, the increase was six-fold within a decade, as Table 1 below shows.

Table 1. Revenue from the Tariff Before and After the Introduction of the Federal Tax Power

State	1785-1788	1792-1795
New York	$ 603,000	$ 4,653,000
Philadelphia	622,000	4,299,000
Baltimore	346,000	1,829,000
Charleston	404,000	1,064,000
Total	$1,975,000	$11,845,000

Source: Edling and Kaplanoff (2004: 739).

But the debt, even if large, was of a limited scope and the constitutional power to tax – once given to the federal government - was there to stay. So, what would the federal government do with those revenues once the wartime debt is paid off? It was decided to link the power to tax with federal obligations. Namely, the Union was to be responsible for the military expenditures or "common defence" to use the wording of the US Constitution (the largest and virtually the only public expenditure at the time) and to use the future revenues for that purpose. Hence, the states would not have to go into debt in case of a future war - the federal government would be liable for any war-related debts and it would be able to do so due to a collateral for loans in the form of the expected revenues from the tariff. Thus, the tax and its fiscal purpose had been linked (see Wozniakowski 2018a for details).

To be sure, for some states it was easier to accept such a pooling of the tax power than for the others, and the main reason for this divergence were the differences in their geographies and economies. Unsurprisingly, the coastal states with large, vibrant ports and trade as a significant part of their economies, such as Rhode Island or New York, were against such a transfer of tax powers, because their own budgets relied heavily on tariff, the anticipated federal tax (for instance, revenue from tariff provided more than half of New York state budget [Wozniakowski 2018b, p. 58]). Other states, with no such ports and economies mainly based on agriculture, rather than trade, were generally in favour of this federal power to tax. Part of the reason was that these agricultural states had to pay their share of the custom duties imposed by the trading states, like New York, without benefiting from this income. This was due to the fact that agricultural states were also buying imported goods from the merchants, who included the coastal states' taxes in the price of these goods. As a matter of fact, the states which more strongly opposed the federal power to tax were also the most prominent opponents of the Constitution - for instance Rhode Island ratified it only when the first Congress was already in session, and New York as a ninth one and the last one of the big four (after Pennsylvania, Massachusetts and Virginia). As always, however, issue-linkage provided incentives for those states to also end up endorsing the federal tax. One of the reasons for New York to finally accept losing the main source of its revenue, was the fact that the revenue from the federal tariff was to be devoted to a "common defence". As the state most exposed to a potential foreign invasion, New York was expected to be one of those most to gain from this new federal duty.

3. Why citizens support the introduction of European taxes – survey data[VI]

One of the main arguments against an EU tax power, or equivalent, is that EU citizens would never support any new taxes. In fact, the example of the US demonstrates that a new tax power may actually be welcome if it were linked with a fairer distribution of the tax burden.

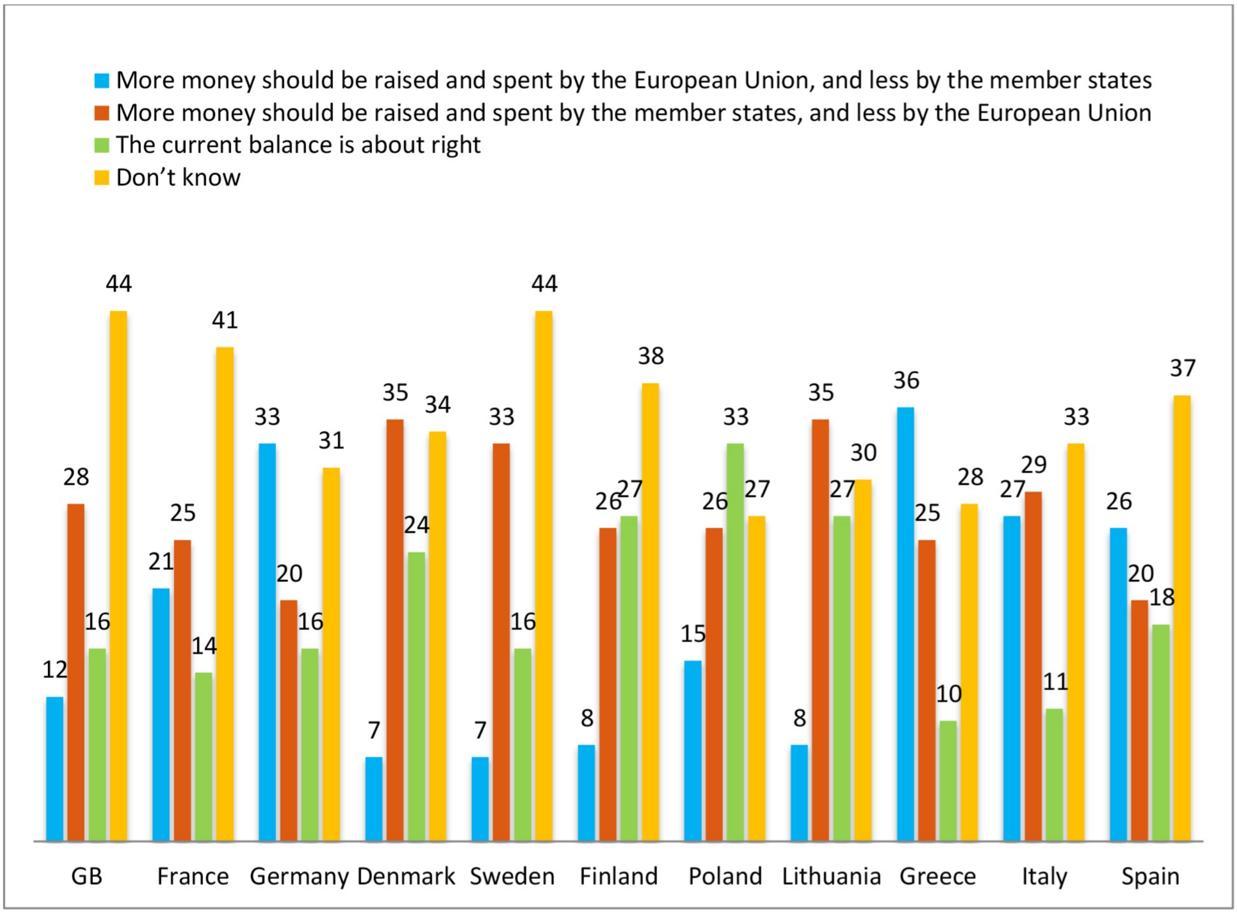
This is the basis for our argument. In fact, the secret for a successful approach to new own resources is to link the growth in revenue with a fairer distribution of the current tax burden in the EU member states (De Grauwe 2006; Demertzis and Wolff 2020; Poiares

Maduro 2012). This will actually help to support, instead of undermining, EU legitimacy. If crafted well these resources could make the Union more politically intelligible by highlighting areas where it has an added value with respect to member states (notably by reinstating tax fairness) or correct negative externalities (Poiares Maduro, 2012: 13).

It was to test this hypothesis that one of us (Poiares Maduro) conducted with You Gov, in the context of the State of the Union of the European University Institute, a survey in 11 member states and asked above 11,000 citizens a number of questions about the revenues and budget of the EU. The opening question regarded the preferences with respect to money raised and spent by the EU and the member states.[VII] Not surprisingly, as shown in Graph 1 below, citizens in a majority of the sample member states favoured the option that "more money should be raised and spent by the member states, and less by the European Union". Perhaps also unsurprisingly, Spain and Greece, as net beneficiaries of the EU budget, were the two countries where there was a majority in support of a stronger EU budget even at the expense of state budgets. Interestingly, however, a small majority in Germany also favoured the EU to raise and spend more money, and the member states less. In several states (notably Sweden) there was a large number who responded that they did not know.

The most significant conclusion was that, overall, there was a strong correlation between States that are considered to be net contributors to the EU budget and larger majorities opposed to a bigger EU budget. This result seems to confirm the popular idea that citizens are more opposed to more money for the EU the more they perceive their State as being a net contributor and not a net beneficiary of that budget. More importantly it underscores the extent to which the way the EU budget is perceived as a zero-sum game. This trend can be exemplified with the most popular slogan of the Leave campaign of the Brexit referendum "We send the EU £350 million a week - let's fund our NHS instead". The way the EU budget is currently funded - mostly by transfer from the national budgets – promotes that zero-sum understanding and hides the true nature of the economic benefits and costs of the Union. In addition, the asymmetry between the national funding of the EU budget and the diffuse nature of most of its economic benefits (through the internal market) further undermines the support for the EU budget.

Graph 1. Approval and Rejection of Division of Raising and Spending Competences between the EU and the Member States in Eleven European Countries

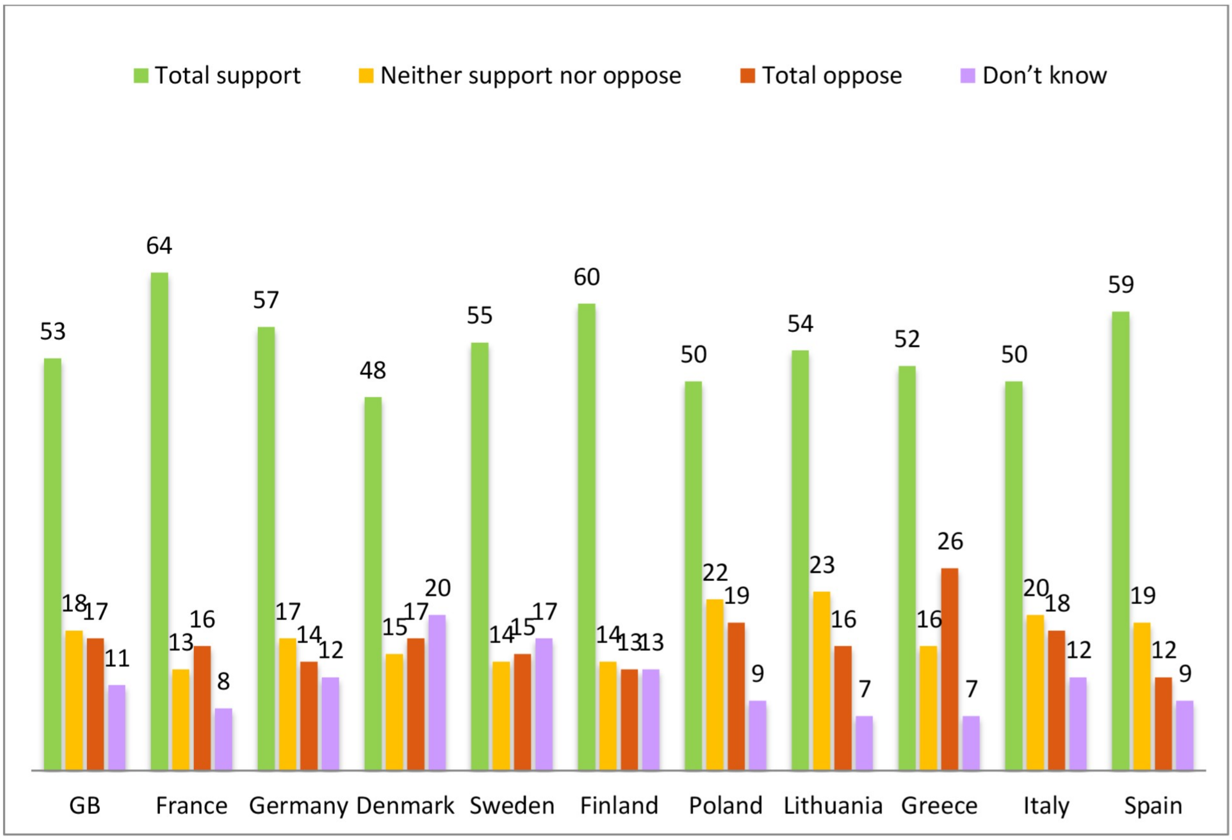


Note: Answers to the question: "Thinking about the money that is spent by the European Union and the money that is spent by member states, which of the following best reflects your view?"
Source: Poiares Maduro 2018

However, this picture changed substantially in the survey once we moved to a different set of questions, in which the following was asked: "Would you support or oppose the EU introducing new European taxes on the following?". The subsequent four questions asked about the preferences regarding the introduction of the following four types of taxes:

1. Carbon emissions by businesses;
2. The revenue of large internet companies;
3. Financial transactions (such as trading in shares); and
4. Business profits.

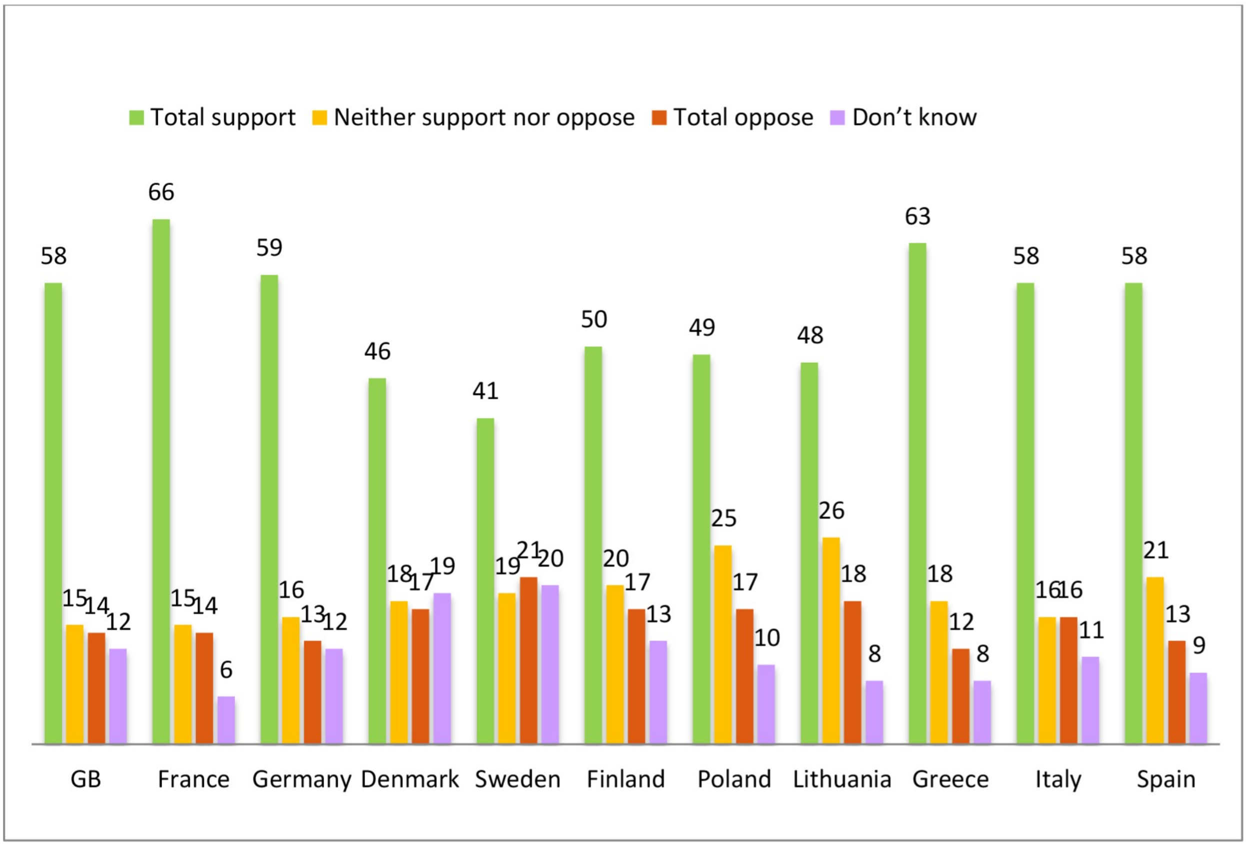
Graph 2. Approval and Rejection of European Tax on Carbon Emissions by Businesses in Eleven European Countries



Note: Answers to the question: "Would you support or oppose the EU introducing new European taxes on the following? Carbon emissions by businesses"
Source: Poiares Maduro 2018

The surveyed citizens supported the introduction of the four taxes in virtually all the states in which the survey was conducted. As shown in Graph 2 above, the highest support was for the tax on carbon emissions by businesses - in all countries support for it was above 50% (Denmark being the only exception with 48% but still much higher than those opposing, only 17%). The introduction of EU carbon tax was the most popular in France, Finland and Germany, while the "total oppose" answer was chosen by less than 20% in all countries but Greece (26%).

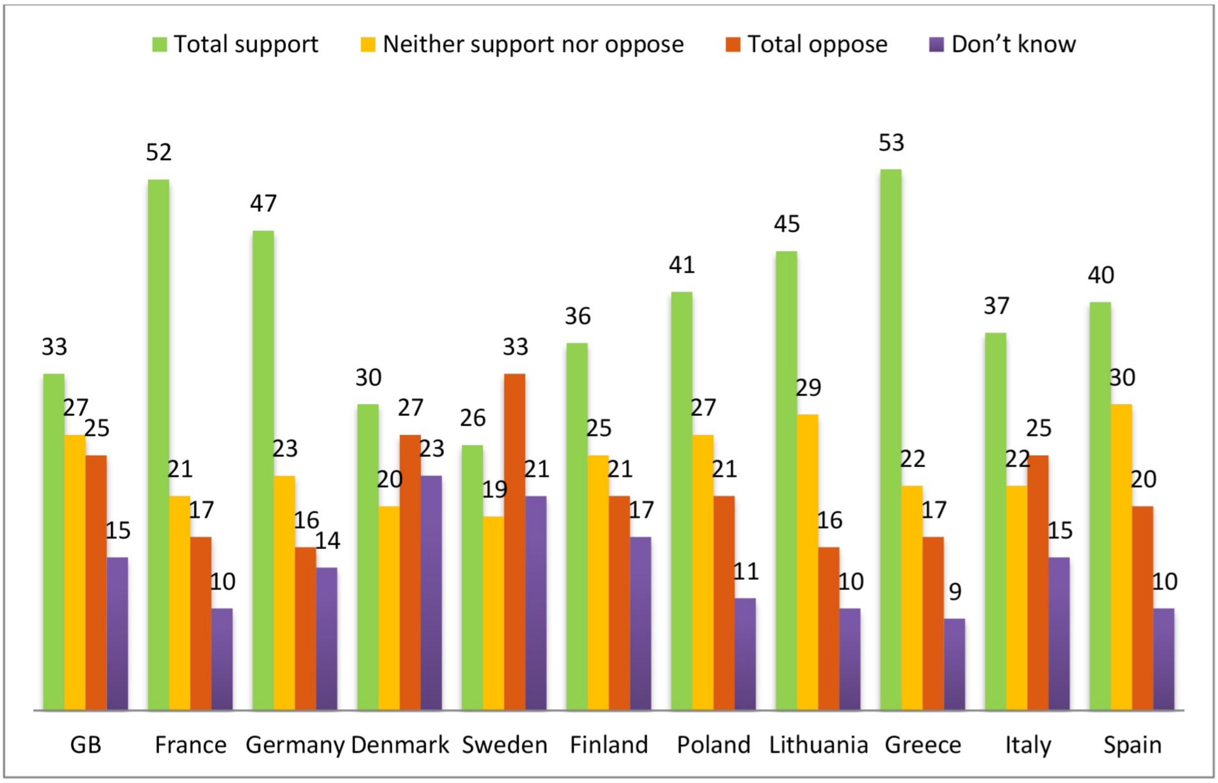
Graph 3. Approval and Rejection of European Tax on the Revenue of Large Internet Companies in Eleven European Countries



Note: Answers to the question: "Would you support or oppose the EU introducing new European taxes on the following? The revenue of large internet companies"
Source: Poiares Maduro 2018

The second most popular was a European tax on the revenue of large internet companies as shown in Graph 3. A majority supported it in all States and only in four countries was the support less than 50% (but more than 40%). The strongest opposition was in Sweden, but even there only at 21%. In all other countries, the support was more than double than that opposing it, with the highest in France, Greece and - again - Germany. The third most popular was the tax on financial transactions (such as trading in shares), as one can see in Graph 4 below. Only in one country - Sweden - there was more opposition (33%) than support for this tax (26%). In Greece, France and Germany support was the strongest.

Graph 4. Approval and Rejection of European Tax on Financial Transactions (such as Trading in Shares) in Eleven European Countries



Note: Answers to the question: "Would you support or oppose the EU introducing new European taxes on the following? Financial Transactions (such as Trading in Shares)"
Source: Poiares Maduro 2018

The fourth type, the tax on business profits, was the least popular but, even in this case, there was only a majority opposing it in one country (Denmark, by a narrow margin: 28% opposing and 25% supporting it) as shown in Graph 5. In Sweden there was a draw: support and opposition were equally divided (32%). In all other states, the support was above 30%, and in two – Germany and Spain it was at the high level of 50%. All questions presented relevant levels of indifference (neither support nor approve) and unfamiliarity (don't know), between 20 and 30%. In any case, the level of support for these possible new European taxes could be classified as overwhelming. It was almost always the double of those opposing it and, in most instances, well above the 50% mark of all the answers given.

We could see that France and especially Germany, the two largest EU states in the survey, repeatedly ranked the highest in the support for European taxes. In fact, Germany, perhaps