The Fiscal Anatomy of Multilevel Governance: The EU and the Regulation of Taxation

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In the decade-long debate about the nature of the European Union, multilevel governance is now the consensus model. Its most popular variant argues that the EU is a "regulatory state" which mainly deals with market integration but leaves issues of high political salience such as taxation to the member states. While there is indeed no trace of an EU power to tax, we show that contrary to the consensus view the EU by no means leaves taxation to the member states. Instead, it massively constrains their tax base, tax rates, and tax systems. We conclude that the EU does not only regulate markets but also core political issues such as taxation. The combination of the European regulation of taxation and the maintanance of member state power to tax is an essential characteristic of multilevel governance in the EU.

1. Introduction

The exploration of the "nature of the beast"[1] has puzzled students of the EU for many decades and has generated a long debate.[2] This debate is not a mere exercise in classification. It is instead about finding a substantial answer to one of the most fundamental questions of EU studies and also of

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1 Risse-Kappen 1996.

2 Major contributions include Beck and Grande 2007; Caporaso 1996; Haas 1971; Marks, Hooghe and Blank 1996; Majone 1994; Puchala 1972; Ruggie 1993; and Schmitter 1996.

EU politics – the relationship between the EU and its member states. More than forty years ago, the early protagonists of the debate proposed strongly diverging alternative views of either a strengthening or a weakening of the state and of a zero-sum relationship between the European and the national level. While there were also more complex views, much of the debate was framed in these terms.[3] During the last decade, the once heated debates seem to have given way to a new standard model which conceives of the EU as a system of multilevel governance.

In our view, the widespread use of the concept of multilevel governance does not provide a satisfactory answer to the question about the relationship between the EU and its member states. In the next section, we argue that the current usage of the concept actually comprises two distinct meanings. The first sees multilevel governance as a gradual practice of power sharing between levels of governance which is common to most larger polities including states, the EU and possibly international organizations. This position explicitly rejects categorical arguments about a weakening or strengthening of the state. The second conceives of multilevel governance in the EU as a highly specific form of power sharing which gives the EU the power to regulate markets but leaves essential political tasks such as defense, policing, welfare spending or taxation to the member states. Independently from their positions within the large multilevel governance camp, virtually all authors agree that the EU has very little powers in the field of taxation.

In the following sections, we take a closer empirical look at this "no taxation" thesis. We first analyze the development of the EU's income and find that initial weak beginnings of a financial resource independent from the member states have over time been replaced by an increasing reliance on direct contributions from the member states. There is no trace of an EU power to tax. This seems to confirm the prevailing conceptualization of the EU which is strong in market regulation but leaves issues of high domestic concern such as taxation to the member states. However, this is not the whole story. In the forth section we present a comprehensive analysis of EU secondary tax legislation and of ECJ rulings relating to taxation between 1958 and 2007. Here, we find that contrary to the conventional wisdom the

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3 See Haas 1964 and Hoffmann 1966 for brilliant and influential statements of the initial positions. Haas 1971, 30-31 proposes a set of more complex models which go beyond the zero-sum logic.

EU massively constrains the member states' tax base, tax rates, and tax systems.

Our empirical findings clearly disconfirm the widespread "no taxation" thesis: The EU has strong regulatory control over taxation and by no means leaves it to the member states. The significance of this result goes beyond the field of taxation. We claim that the regulatory state model of multilevel governance in the EU must be extended. Regulation at the EU is not limited to market regulation but reaches into political and redistributional issues. Operationally, these policies are still carried out by the member states. However, the EU strongly regulates the terms of what member states can do. In the European multilevel system, the state is neither weakened nor strengthened but becomes embedded into a larger regulatory structure.

2. Multilevel Governance and Taxation

Since the 1990s, an increasing number of scholars writing about the nature of the Euro-polity have come to agree that it is a system of multilevel governance. This conceptualization now seems close to a consensus view on the Euro-polity which is not only shared by those who have made the argument for quite some time[4] but also by those who were believed to oppose it.[5] Despite attempts to revitalise federalist thinking on the EU,[6] there seems to be no serious alternative to the prevailing conceptualization that the EU is a multilevel system.

The increasing use of the term has not, however, made it more precise. On the contrary, its unclear content may be the reason for its very success in recent years. If "multilevel system" simply refers to a political system with two levels of government, virtually any political system is a multilevel system and not much follows from this classification. As a response to the danger of conceptual stretching, two clearly distinct ways to fill the term with content have emerged in the literature.

The first conceptualization of a multilevel system provides an analytical

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[4] E.g. Bache and Flinders 2004; Benz 2003; Hooghe and Marks 2001 and 2008; Jachtenfuchs 2001; Scharpf 1997. See Pollack 2005, 379-87 for an overview.

[5] Moravcsik 2004, 356 and 2005, 384 (footnote 69).

[6] Kelemen and Nicolaïdis 2007.

approach for looking at the distribution of authority between levels of government and changes of this distribution over time. In the field of EU studies, this approach has been pioneered by Leon Lindberg who measured the locus of decision-making in the EU with an ordinal scale ranging form 1 (all decisions national) to 5 (all decisions European) over a number of policy fields and over time.[7] His scale has been used and modified several times in later years to capture the evolution of the EU's policy scope and the distribution of powers between the European and the national level.[8]

The scale is based on an incrementalist notion of power-sharing across levels of government. Its main thrust in EU studies is that it rejects the categorical distinction between the state on the one hand and other forms a polity on the other and replaces it by a gradual continuum of the sharing of authority. The main insight of this approach is not that virtually all political systems are indeed multilevel systems but rather to point at the specific configuration of power sharing across policy areas and its change over time. The great advantage of this view is that it helps to overcome ideological battles over the "true nature" of the Euro-polity by looking at empirical data. One disadvantages of this approach is its breadth: If every polity is somehow a multilevel system the debate on the nature of the Euro-polity is not really solved but merely transferred to the interpretation of the scores of the different scales. A second disadvantage is that it does not distinguish between the importance of different policy fields for which authority distributions are measured. In other words, are research, agriculture or competition policy really as important as defence, taxation or monetary policy?

The second conceptualization of multilevel governance in the EU takes a different view. It conceives of multilevel governance in the EU as a substantive model of a polity and not only as an analytical approach to power sharing between levels of government. In this view, the "multi-level governance system of the EU is the only distinctively new form of state organization to emerge and prosper since the rise of the democratic social welfare state at the turn of the twentieth century".[9] This multilevel system is not a federal superstate which simply replicates the main state tasks on a

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[7] Lindberg 1971, 69.

[8] Börzel 2005; Schmidt 1999; Schmitter 1996.

[9] Moravcsik 2005, 376.

larger territorial scale. Instead, it is a regulatory polity with a highly specific division of tasks between the European and the member state level. This institutional setup is neither a historical accident nor a mere transitory phase. As Giandomenico Majone has forcefully argued, the EU has developed into a regulatory polity for two reasons.[10] First, he argues, there was a general trend in advanced industrial states away from taxing and spending policies as the main instruments of governments towards regulation and law-making, in other words a move from the "positive" or "interventionist" to the "regulatory" state. Although this trend was reinforced by increasing competition and economic integration within the EU, it was not initiated by the EU. Only in a second stage, the European Commission strategically used regulation in order to increase its own policy-making authority. As the EU budget was very small as compared to member state budgets, its growth tightly controlled by member states and a large portion of it devoted to specific policies by the EU Treaties or secondary legislation, large-scale spending policies which governments normally use to set political priorities or to increase political support were unavailable political options for the EU Commission. It had no choice but to focus on regulation for setting policy priorities and for increasing its own policy-making authority. Although regulatory policies may lead to substantial costs for enterprises, they had hardly any impact on the EU budget.

As a result of both factors, the EU developed into a regulatory polity. This is the specific form multilevel governance takes in the EU. The EU level has far-reaching policy authority in the field of market-regulation. With the Commission monopoly of legislative initiative, qualified majority voting in the Council, the European Parliament as a co-legislator, and a hierarchical legal system with the pro-market jurisprudence of the European Court of Justice, the EU level enjoyed a high degree of independence from the will of individual member states.[11] Other typical tasks of modern states

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[10] Majone 1994 and 1997. For a later empirical review of the thesis see Lodge 2008. Although Majone initially used the term "regulatory state", he preferred to speak about the "regulatory model" in later publications and hence insisted on the difference between a (federal) state and a regulatory polity such as the EU. C.f. Majone 2005, 145-47.

[11] C.f. Caporaso 1996; McGowan and Wallace 1996; Young 2007; and, in a different terminology, Streit and Mussler 1995, for further elaborations on the EU as a regulatory

such as redistributive welfare policies, policing, taxation, or defense are largely carried out by the member states without much EU involvement. In other words, the second conceptualization of multilevel governance sees a fundamental feature of the EU in its "far-reaching separation of state power from market power".[12] In this view, which is the prevailing conceptualization of multilevel governance in the EU, the Euro-polity is clearly distinct from a federation because federations also have "state power" in the areas of defense, policing, or taxation, to name but the most important ones. The EU does not have these powers.

The common conviction of both conceptualizations of multilevel governance disussed above is that the EU has no taxing power. In Tanja Börzel's analysis of the level and scope of EU policy-making over time, taxation constantly scores 1.5 from the Rome Treaty of 1958 to the Draft Constitutional Treaty of 2004, meaning that member states control it almost completely.[13] Schmidt finds few signs for a Europeanization of German tax policy.[14] For Moravcsik, taxation is largely excluded from the EU policy agenda.[15] Stone Sweet states that "the EC governs principally through making rules …; it has little capacity to govern through taxation …".[16] Even for those who do not share the multilevel polity view, taxation is still "firmly in the hands of national governments".[17] Tsoukalis bemoans that with respect to taxation, the EU has spent an "inordinate amount of time with rather little to show for it."[18] Hix nicely summarizes the prevailing view: "The EU is a multilevel system of government, which allows European citizens to make decisions about regulation of the continent-wide market at the European level while maintaining power over taxation and

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state.

12 Majone 2005, 35.

13 Börzel 2005, 223.

14 Schmidt 1999, 391.

15 Moravcsik 2002, 607. Moravcsik 2005, 365 states that in the field of tax harmonization, EU policy plays a subordinate role.

16 Stone Sweet 2004, 239.

17 Newton and van Deth 2005, 332.

18 Tsoukalis 2005, 127.

spending at the national level".[19]

This "no taxation" thesis can easily be subjected to empirical scrutiny. This is what we well do in the remainder of the paper. The significance of such an analysis goes beyond the test of an empirical claim about the role of the EU in a particular policy field. Taxation is not a policy field like any other. Instead, the power to tax is widely believed to be a defining and essential characteristic of the modern state, a feature which distinguishes the state from other forms of political organization. For Karl Marx, it was the "source of life" of the modern state.[20] Many writers have argued that the states lives almost exclusively on tax revenue. The structure and level of such revenue determines to a large extent what it can do and what it cannot do, how many civil servants it can hire, how ambitiously it can define its policy goals, and by what means it can pursue them. A fiscal sociology of the state[21] can thus yield important insights for understanding the state – and by analogy also about other types of polity.

Precisely because the power to tax is so fundamental to the state, changes of the state are to be reflected in (and often caused by) changes in taxation. This is also the reason why so many analysts are firmly convinced that changes in other policy fields notwithstanding, EU member states will preserve their policy-making autonomy in the field of taxation. The analysis of taxation is therefore one of the best starting points for analyzing the structure of the European multilevel system. Unfortunately, taxation is generally considered to be dry, technical and boring, and students of European integration usually pay scant attention to it.[22] As a result, the widespread "no taxation" thesis lacks systematic empirical support. To provide such a systematic analysis of taxation in the EU with a view to obtain a better understanding of multilevel governance in the EU is the task of the following two sections.

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[19] Hix 2008: 11.

[20] Cited in Campbell 1993: 164.

[21] Major works in this tradition next to the classic "crisis of the tax state" (Schumpeter 1991) include Goldscheid 1917; Mann 1934; O'Connor 1973; Levi 1988; and Steinmo 1993.

[22] With the notable exception of Puchala 1984 and Radaelli 1997.

3. No EU Taxing Power

On a first look, there is substantial evidence for the "no taxation" thesis. Unlike its member states, the EU has neither the legal right nor the administrative means to impose compuslory payments on individuals or corporations. It has no taxing power. This is even more remarkable because the introduction of a genuine EU tax is a perennial issue in European politics. The Commission, supported by various expert panels and pro-European policy-makers, has fought for it since the 1960s. It claimed that European level taxes would improve market integration, facilitate the operation of monetary union, and bring the EU closer to the citizen by establishing a direct fiscal link to them.[23]

These efforts did not bring about success. Today, the EU is no closer to having a tax of its own than the European Coal and Steel Community (ECSC) was back in the 1950s. In fact, it is even further away because, as we will show, the importance of tax-like supranational levies for funding the Community budget has decreased, and the importance of national contributions has increased over time. Over time, there is a pervasive trend towards intergovernmentalism in the financing of the EU. Its so-called own resource system gravitates towards a funding scheme consisting of national contributions which is essentially similar to that of international institutions such as the UN, and fundamentally dissimilar to the tax systems of federal, let alone unitary nation states.

The ECSC Treaty of 1951 still contained the seeds of a genuine European power to tax.[24] It empowered the High Authority to impose supranational levies on the production of coal and steel, and gave it considerable discretion ot autonomously set the rate and base of these levies. The levies were collected directly by the ECSC from individual coal and seel companies and without any administrative assistance from the member states. This system bore a close resemblance to supranational taxes.[25]

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[23] As a selection of the most important documents, see Neumark Report 1963; MacDougall Report 1977; Commission 1992; Commission 1998; European Commission 2004.

[24] C.f. Articles 49 and 50 of the ECSC Treaty.

[25] Strasser 1992, 74.

Already the Treaty on the European Economic Community (EEC) of 1957 returned to an intergovernmental mode of financing European institutions and policies based on national contributions by the member states. It did, however, call for an eventual replacement of this system by a new, presumably supranational, system of “own Community resources”.[26] In 1970, the Council decided that customs duties and agricultural levies were to become the first two own resources to the Community. As in the case of the ECSC levies, the rate and the base of these so-called traditional own resources are set by decisions on the European level in the framework of the common commercial policy and the common agricultural policy respectively. Like the ECSC levies, they are charged directly on economic agents (importers and agricultural producers), thus creating a direct, tax-like fiscal link between the Community and individual or corporate citizens. Unlike ECSC levies, however, the traditional own resources are collected by national rather than European authorities and pass through national budgets rather than directly to the European budget.[27] Since the agents paying customs duties or agricultural levies are mostly corporate actors and do nto represent the European citizenship at large, the traditional own resources did not create the visible fiscal link between the European institutions and the citizens which the Commission and other ardent supporters of a federal Europe had longed for. Also, they serve primarily non-fiscal objectives such as trade liberalization and the stabilization of agricultural prices. It was obvious from the beginning that they would not be sufficient to match the rising revenue requirements of the Community.

The so-called VAT[28] resource, introduced in 1979, was supposed to alleviate both problems. Envisaged as a European deduction of up to 1 per cent from national VATs (the so-called “base-on-base method”), it would have allowed the Community to tap into a buoyant source of revenue and at the same time would have increased the Community’s profile as a revenue raiser in its own right. However, the implementation of the base-on-base method would also have required a complete harmonization of national VAT bases because otherwise member states would have been able to reduce their contributions to the European budget by reducing their VAT

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[26] Art. 201 EC Treaty (now Art. 269).

[27] Strasser 1991, 88-90.

[28] VAT = value added tax.

base. While the Council achieved a substantial approximation in 1977, a complete harmonization proved elusive. This made the deduction approach unfeasible and tipped the scales in favor of a purely statistical approach to collecting the VAT resource (the so-called “revenue method”).[29]

The revenue method was convenient because it was easy to administer but it changed the character of the VAT resource from a direct European charge on final consumers to a national contribution by the member states. Despite its name, the VAT resource is not directly linked to the VAT payments of European consumers. It represents a national payment obligation of the member states rather than an individual payment obligation of EU citizens. In essence, it is a purely statistical construct, calculated from harmonized data on aggregate national consumption, paid out of general tax revenue rather than VAT revenue alone, and transferred to the EU in monthly instalments. In view of these factors, critical observers consider the VAT resource as “revenue dressed up as an own resource”[30] but not as a genuine own resource. The VAT resource has nothing to do with a European tax but is in fact a national contribution which is calculated in a complex way.

The introduction of the so-called GNI-resource[31] in 1988 reinforced the drift from supranational levies to national contributions. In contrast to the VAT resource which at least at first sight resembles a tax, the GNI resource was conceived right from the beginning as a transfer from national treasuries and not as a direct charge on European citizens. It is calculated on the basis of harmonized data on the gross national income of the member states without even nominal reference to microeconomic events or actors. While initially planned as a residual source of finance, the GNI resource has turned into the key stone of the own resource system. In 2007, it accounted for roughly 70 per cent of all own resources. If the VAT resource is included, it becomes clear that almost 85 per cent of the EU budget derive

[29] Genschel 2002, 80-95. Denmark used the fiscal base-on-base method until 1982, Ireland until 1985. Afterwards, all member states applied the statistical revenue method; c.f. Strasser 1991.

[30] Strasser 1991: 90; c.f. Laffan 1997, 41.

[31] Until 1995, this resource was calculated on the basis of the gross national product (GNP resource. Since then, it is calculated on the basis of the gross national income (GNI resource).

from national contributions. Only 15 per cent derives from tax-like income which is levied on a highly selective subset of society.

In short, there is a pervasive trend in the EU's finances away from direct charges on individual or corporate citizens towards national contributions of the member states, in other words away from a genuine supranational power to tax towards an intergovernmental revenue system. While the High Authority of the ECSC enjoyed considerable discretion and could autonomously determine both the base and the rate of ECSC levies, the Commission can only propose rates and bases of EU own resources which then have to be adopted unanimously by the Council and ratified by the national parliaments of the member states.[32]

The trend towards national contributions in the financing of the EU is reflected in concerns about inter-nation distributive justice and also propelled by these concerns. They surfaced for the first time after British entry in 1973, and almost paralyzed the EU after Margaret Thatcher demanded "our money back" in 1979. The budget rebate for the UK solved this particular problem in 1984 but at the price of drawing other member states' attention to their budgetary net-positions as well.[33] By increasing the number of net-contributors to the EU budget, consecutive rounds of enlargement further increased the salience of distributive conflicts among the member states. As a consequence, the main cleavage in European budgetary debates is not between social classes as within the member states but between these states themselves. The normative reference point is inter-nation equity and the principle of the national ability to pay as in other international institutions, not inter-person equity and the principle of the individual ability to pay as in domestic politics. This is reflected in cross-national differences in contribution rates to the VAT resource. Nowadays, the UK is not the only country with a budget rebate. Special rates apply to Austria, Germany, the Netherlands, and Sweden, and a base cap is granted to member states with large VAT bases.[34] The increasing intergovernmentalism in the EU budget is also reflected in its size. While in Western federal states, the huge task expansion of the federal government since the late 19th century was accompanied by a huge expansion of the

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[32] See Pietras 2008, 16.

[33] See Laffan 1997, 55.

[34] See European Community 2007.

federal budget,[35] the EU's task expansion since the early 1990s was accompanied by a stagnation of the budget.

A number of observers percieve this trend as pathological. In the eyes of the Commission, it fosters "a narrow *juste retour* stance" of the member states and deflects attention from the benefits of EU policies for Europe as a whole. A direct fiscal link between the European institutions and the citizen could help to reduce this bias and vindicate the EU as "a Union of Member states *and* citizens".[36] The quest for a genuine European tax goes on.[37] However, its visionary appeal testifies to its lack of political plausibility. The creation of a genuine European taxing power is not on the agenda because it would bestow a degree of stateness on the EU that seems ever more unacceptable to the member states after several rounds of enlargement. This all but rules out a genuine European tax and makes the creation of a direct fiscal link between European institutions and citizens exceedingly difficult.

4. The EU's Regulatory Power Over Taxation

While the EU has no taxes of ist own, it has the power to regulate the taxes of the member states. This power to regulate goes far beyond what is usually understood when scholars speak of the EU as a regulatory polity. It is implied by the EU's competence for the Internal Market. The Internal Market is defined as an "area without internal frontiers in which the free movement of goods, persons, services and capital is ensured"[38]. To complete this market, the EU has to intervene in national policies creating such frontiers. Since goods, persons, services, and capital constitute the major tax bases of the member states (in fact there is hardly anything else to tax), this resudual European power to regulate amounts to a very broad mandate covering all major taxes. As we will show in this section, the EU institutions have used this mandate to slowly assert considerable control over national taxation. The member states continue to levy taxes but EU

[35] See Diaz-Cayeros 2004.

[36] European Commission 2004, technical annex pp. 41 and 58. Emphasis in original.

[37] See e.g. Cattoir 2004.

[38] Art. 14 TEC.

institutions increasingly shape them. Two instruments are particularly important in this regard, namely the secondary tax legislation of the Commission and the Council (see section 4.1) and the case law of the European Court of Justice (see section 4.2). In the following, we provide descriptive evidence of the growing use of these instrument and of its constraining effect on national taxation.

4.2. Secondary Tax Legislation

The founding fathers of the EEC clearly understood that market integration would require European tax policy coordination[39] but were concerned to keep the EU's legislative authority limited in this area. The EC Treaty gives some law making powers in the field of taxation to EU institutions but imposes strict substantive and procedural constraints on them. Substantively, it premises EU tax legislation on the needs of market integration. It empowers the Council to harmonize national tax laws but for one purpose only: to ensure the proper functioning of the Internal Market.[40] The fiscal and distributive considerations which animate most domestic tax policy debates are thus systematically excluded from the European tax policy agenda. Of course, once a market integration rationale for tax harmonization has been established, other policy considerations of a fiscal, economic, environmental, or social nature also come into play.[41] It is, however, important to note that these considerations alone cannot justify formal acts of tax harmonization. Procedurally, the Treaty subjects tax matters to unanimous decision-making. As a result, each member state enjoys veto power.[42] It is important to stress that these substantive and procedural constraints have never been relaxed since the ratification of the Treaty of Rome in 1957. Proposals to introduce qualified majority voting invariably met with vocal resistance from sovereignty-minded states such as the UK. Arguably, taxation is now the policy field with the strongest degree

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39 Spaak Bericht 1956.

40 Art. 93 and 94 TEC. Art. 157 (3) TEC even explicitly prohibits the introduction of Community tax provisions for the purpose of improving the competitiveness of European industry.

41 See e.g. European Commission 2001.

42 Art. 93; 95 (1); and 190 (5) TEC.

of intergovernmentalist decision-making at least in the first pillar of the EU.[43] As it is mainly concerned with market integration, the first pillar is usually characterized by widespread usage of qualified majority voting. Qualified majority voting has also been constantly extended to new policy areas over time. The fact that despite this general trend the provisions on taxation have not seen any major change during the last fifty years is a strong indication for the desire of at least some member states to keep the EU out of taxation.

However, these strict Treaty provisions did not prevent a significant growth of secondary tax legislation. Table 1 provides a quantitative summary of all binding secondary tax acts ever issued by EU institutions. It highlights four trends.

-- Table 1 about here --

First, the production of secondary tax law has increased enormously. While the EU of six issued only two tax acts in its first decade, the EU of 15 and later of 25 member states passed almost 200 tax acts between 1998 and 2007. The strict substantive and procedural limits on tax legislation imposed by the Treaty have not prevented that the adoption of secondary tax legislation is now a routine affair in EU politics.

Second, the number of tax areas covered by secondary tax law has also increased. In the 1960s, the focus of EU tax legislation was exclusively on turnover taxation and the introduction of a common VAT system.[44] In the 1970s and 1980s, EU tax legislation extended to excises. The Council agreed on common rules for indirect tax exemptions for individual travellers,[45] and for tobacco taxation, and also made its first cautious advance into the field of administrative cooperation.[46] In the 1990s, it entered the corporate tax field by pasing two directives on the tax treatment

43 Börzel 2005, 222-23.

44 See 67/2277EEC and 67/228/EEC.

45 E.g. 69/169/EEC.

46 77/799/EEC.

of multinational companies.[47] In 2003, EU tax legislation also extended into personal income tax with the so-called savings tax directive.[48] As a result, the four major taxes (VAT, excises, personal income tax and corporate tax) which together account for roughly 85 per cent of total tax revenue[49] in the EU-27 are now covered by EU tax law. However, as Table 1 also shows, the coverage is very uneven. The vast majority of secondary EU tax law concerns indirect taxation (i.e., VAT and excises) while the number fo direct tax acts (corporate and personal income tax) is rather low. Closer inspection reveals that the systems, base definitions, rate structures and administrative procedures of VAT and excise taxes are regulated comprehensively and in great detail while the harmonization of direct taxation remains rather sketchy. The corporate tax directives focus on selected aspects of the tax treatment of multinational companies but do not deal with the corporate tax base in general or any other aspect of corporate taxation. Harmonization in personal taxation is narrowly limited to the tax treatment of individual cross-border savings. The difference in detail is also reflected in the different length of the directives. While the new VAT systems directive[50] alone covers 118 pages in the EU's Official Journal, the three corporate tax directives[51] taken together cover only sixteen pages.

Third, the variety of legal instruments has grown. In the first thirty years of integration, the *directive* was virtually the only instrument of secondary tax legislation. As the directive is not directly binding but requires implementing legislation by the member states, it is the instrument of choice for sensitive areas such as taxation. Indeed, it is still the preferred instrument for major acts of tax harmonization such as the horizontal excises directive of 1992,[52] the savings directive of 2003, the introduction of the transitional system of VAT in 1991,[53] or the new VAT system directive in 2006. However, since the late 1980s the number of tax policy *decisions*

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47 90/434/EEC and 90/435/EEC.

48 2003/48/EC.

49 Own calculations based on Eurostat 2007.

50 2006/112/EC.

51 90/434/EEC; 90/435/EEC; and 2003/49/EC.

52 92/12/EEC.

53 91/680/EEC.

has rapidly increased and has overtaken the number of directives in the 1990s. The Council decision is now the most common instrument of EU tax legislation. It is mostly used to authorize specific derogations from general tax directives for individual member states. In a way, it provides a safety valve against overly restrictive harmonization. The accelerated growth of tax decisions provides prima facie evidence of the increasing restrictiveness of EU tax harmonization and testifies to the high level of European involvement in national tax policy making. Finally, *regulations* have also become somewhat more common since the 1980s even though their absolute number is still quite low. As regulations are directly binding for member states and economic agents without any additional national legislation, member states usually try to avoid them in sensitive areas. Their importance In the field of taxation is indeed reduces because most of them lay down implementing provisions for other secondary tax law, especially directives.

Fourth, there is a mild trend towards delegated tax legislation. While in the early decades of Euroepan integration, all tax acts emanated from the Council of Ministers, more recently a small but increasing number of decisions and regulations have been issued by the Commission. The legal basis of these acts is provided by "parent" legislation of the Council which delegates law making powers for specific purposes to the Commission. The horizontal excise directive, for example, delegates authority over some administrative aspects of the common excise system.[54] The new VAT system directive empowers the Commission to regulate reduced tax rates for gas, electricity and district heating.[55] While the substantive scope of delegation is limited, it is still remarkable that law-making powers are delegated at all given the member states' strong insistence on retaining untrammelled sovereignty over taxation.

In short, the qualitative evidence suggests that the frequency, coveranga, and variety of tax legislation have greatly increased. A growing number of issues concerning the rate, shape and administration of national taxes are now formally decided by the Commission and the Council. However, the evidence also shows that the extent of legislation varies greatly across taxes. Indirect taxes and especially VAT and the major excises are regulated

[54] 92/12/EEC, Art. 24.

[55] 2006/112/EC, Art. 102.

comprehensively while direct taxation is hardly regulated at all. This makes sense because indirect taxation has a higher potential of market distortions than direct daxation. It does not mean, however, that direct taxation remains a predominantly national affair because since the mid-1980s, the ECJ has developed a large body of case law on the compatibility of direct tax rules with primary EU law.

4.2. ECJ Tax Jurisprudence

The legal order of the EU empowers the ECJ to review the consistency of national law, including tax law, with the *acquis communautaire*. Cases can be brought by other member states, by the Commission or by private tax payers via the preliminary rulings procedure. Each tax case just concerns a particular tax rule in a particular member state but the resulting case law has a harmonizing effect across taxes and member states because, by providing detailed reasons why this particular rule is (not) in line with EU law, it establishes general principles of acceptable tax policy for the EU as a whole.[56] To be sure, these principles do not tell member states what policies to adopt but rather what policies not to adopt. Judicial harmonization is negative harmonization. This is one major difference to the positive harmonization effected by the Council's secondary tax law.[57] Table 2 provides a quantitative overview of the tax jurisprudence of the ECJ. It highlights four trends.

-- Table 2 about here --

First, the absolute number of tax cases has increased enormously. While the ECJ handled only four tax cases between 1958 and 1967, it processed more than 400 such cases between 1998 and 2007.

Second, the number of tax areas covered has risen. For a long time, the tax jurisprudence of the Court focused almost exclusively on indirect taxes (mostly VAT and excises). Since the 19990s, however, the number of direct tax cases (mostly concerning corporate and personal income taxes) has grown significantly. While the ECJ rendered only twenty judements on direct taxation between 1988 and 1997, this number increased to 101

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[56] For a general treatment of this issue, see Stone Sweet 2004, 30-35.

[57] McLure 2007, 130.

between 1998 and 2007. The relative share of direct tax cases grew from less than ten per cent of all tax cases (1988-1997) to almost 25 per cent (1998-2007). All major taxes are now under constant judicial review by the ECJ.

Third, the number of cases concerning the interpretation of secondary tax law has grown much faster than that of cases concerning primary treaty law. More than 70 per cent of the cases rendered between 1998 and 2007 dealt with secondary law (292.5 out of 417). Unsurprisingly, a closer inspection reveals that this share is much higher in indirect taxation where almost 98 per cent of all VAT cases between 1998 and 2007 (203 out of 208) concerned secondary VAT law. This share is much lower in direct taxation where little secondary law exists. Only about 20 per cent of all the corporate tax cases (10 out of 46.5) and no case concerning personal taxes related to secondary tax law.[58] In other words, in indirect taxation the ECJ rules *on* the secondary legislation of the Council while in direct taxation it mostly rules *in lieu* of Councuil legislation. In the former case, the jurisprudence of the ECJ adds to the legal constraints implied by secondary legislation. By clarifying the meaning of this legislation it tends to whittle away some of the formula compromises and ambiguities which originally secured the unanimous passage of this legislation in the first place.In the later case, it engages in judge-made European legislation in a tax field in which the Council has traditionally refused to legislate because the member states could not or would not consider European level legislation.

Most direct tax cases before the ECJ concern the compatitility of national tax provisions with the general non-discrimination and free movement guarantees of the EC Treaty.[59] Direct tax regimes are liable to violating these guarantees because historically they were designed to ensure efficiency and distributive fairness within national boundaries rather than non-discrimination and unrestricted movement across them. Governments have built up protective walls to prevent the mobile tax base from leaking out to other states by, for example, limiting tax advantages to domestic situations or imposing extra tax or administrative requirements on

[58] The only exception is case C-87/99 (*Zurstrassen*) which amongst other issues dealt with the implications of the non-tax Council Regulation 1612/68/EEC for personal income taxation.

[59] For more detail see Terra and Wattel 2005, 27-197; Aujean 2007; and van Thiel 2007.

international situations. In general, the ECJ has taken a very critical view on these arrangements, and beginning in the 1980s, started to shoot them down in the name of the market freedoms. This judicial onslaught triggered a wave of national tax reforms. Governments in Finland, France, Germany, Ireland, Italy and elsewhere eliminated the once popular but inherently discriminatory imputation system of corporate taxation. Also, domestic tax advantages were extended to cross-border situations or eliminated altogether in order to make tax base definitions more internationally neutral and thus pre-empt anti-discrimination litigation. Indirectly, the ECJ's tax jurisprudence also affected national tax rates because by eliminatingt tax barriers it fuelled international tax arbitrage and, hence, corporate tax competition in the Single Market.[60] The corporate tax jurisprudence also ha dimportant knock-on effects on personal taxation, for example as regards the treatment of individual wealth and capital income.[61]

Fourth, Table 2 shows that the tax jurisprudence of the ECJ is mainly characterized by two types of proceedings, references for preliminary rulings and infringement procedures (i.e. actors for failure to fulfil obligations). While the frequency of both proceedings has strongly increased, preliminary rulings have always outnumbered infringement procedures by a significant margin. In recent years (1998-2007), the ratio has been five to one (340 to 68). The predominance of the prelimininary rulings procedure gives the tax litigation before the ECJ a tax reduction bias because private tax payers will incur the costs of litigation only if they expect that a success will reduce their tax bill.[62] To the extent that private litigants are successful in their actions, as for the reasons just stated they often are, they lend encouragement to other potential litigants to follow their example and also reduce their tax burden by attacking restrictive national tax provisions for incompatibility with the Treaty freedoms. Thus, successful litigation begets more litigation and increases the pressure on national treasuries.

Infringement proceedings are almost invariably initiated by the Commission. The Commission uses these proceedings in order to ensure member state compliance with existing EU law but also to create new law.

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[60] Genschel et al. 2008.

[61] C.f. Terra and Wattel 2005, ch. 3.

[62] Graetz and Warren 2007, 293.

Targeting tax obstacles which the member states refuse to remove by way of legislative harmonization, it hopes to instigate case law which removes them by way of judicial harmonization.[63] The accumulation of case law may then in turn facilitate consensus building on legislative harmonization.

More recently, the Commission has also started to issue non-binding communications on the tax jurisprudence of the ECJ, especially with regard to direct taxation.[64] These communications remind the member states of their duty to adjust national tax policy to this jurisprudence and provide guidance as to how to do that. They also alert private tax payers to promising targets of litigation and serve as thinly veiled threats that ultimately the Commission could initiate infringement proceedings if member states refuse to comply with its reading of the case law. In this way the Commission hopes to reinforce the negative harmonization effect of ECJ rulings and increase active policy coordination among the member states.[65]

4.3. Secondary Tax Legislation, ECJ Case Law, and Member State Autonomy

As the density of legislative and judicial European tax laws increases, the substantive and procedural Treaty constraints, originally intended to safeguard national tax policy autonomy, turn against it. The unanimity requirement tends to lock the member states into a legal status quo which is partly not even of their own making but that of the ECJ. To be sure, each European tax provision, be it of legislative or of judicial origin, can be revised if the Council of Ministers unanimously so agrees. However, as long as this agreement is not forthcoming, the member states have to apply the old law unchanges. This stifles policy innovating and change.[66]

In the field of indirect taxation, French President Nicolas Sarkozy, for instance, campaigned on a pledge to reform the structure of French VAT rates in order to make the tax more equitable and efficient but could not make good of this pledge because the structure of VAT rates is regulated by EU law, and no unanimity among the member states for a reform of these

[63] European Commission 2001, 21.

[64] For a recent example see European Commission 2007.

[65] Aujean 2007, 329.

[66] In a more general way, this argument is developed in Scharpf 2006.

regulations is in sight.[67] The hurdles to a political revision of ECJ rulings interpreting primary instead of secondary law are even higher as they require not only a unanimous decision of the member states but also subsequent ratification of the agreement in all member states. This gives the ECJ particular discretion over precisely those tax issues, most notably in direct taxation, which the Council cannot or will not agree to regulate by secondary legislation.

In the field of direct taxation, a political revision of ECJ interpretations of primary law is even more difficult. First, the fact that there is no secondary law in this field is an indicator of the disagreement in the Council about how European rules in this field should look like and whether there should be European rules at all. This makes unanimous agreement among the member states revising an existing ECJ jurisprudence in this area highly unlikely. Second, the member states do not have the possibility of uninimouly adopting individual exemptions to the general rules of primary law as interpreted by the ECJ. This is only possible in the case of secondary law where more specialized decisions, even if they have to be adopted unanimously, can grant individual exemptions from more general directives. In sum, the unanimity requirement which was originally created in order to safeguard the member states autonomy in the field of taxation from EU influence now contributes to a judicialization of tax policy and thereby increases EU influence instead of reducing it.

To the extent that European tax law constrains national taxation, considerations of market neutrality and integration come to domitate fiscal and distributive considerations in tax poliy making. Partly this is due to the substantive Treaty requirement that all secondary tax law has to serve a market integration rationale. Partly it follows from the ECJ's refusal to accept the revenue needs of the member states as an "imperative requirement of public interest".[68] In any case, taxationis not treated as an end in itself but as a means to an end. It has no positive content as in domestic tax policy – where the financing of public goods or the promotion of distributive justice are popular and legitimate justifications of tax policy decisions – but only a negative one, namely the elimination of obstacles to

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[67] EurActiv 2008.

[68] Aujean 2007, 325.

market integration and neutrality.[69] Hence, the spread of European tax law means not only that national taxes are increasingly shaped by EU rules but also that these rules are alien and sometimes histile to the policy considerations which dominate domestic tax policy discourses.

The strong quantitative growth of EU tax law and ECJ tax jurisprudence which we analysed in the preceding section makes a significant qualitative difference for national taxation. Taxes remain national but are increasingly constrained by European rules and regulations. The constraining effect varies across taxes. Indirect taxes are more thoroughly regulated than direct taxes and corporate taxes more thoroughly than personal income taxes. It also varies across tax instruments. Tax systems and tax base definitions tend to be more narrowly circumscribed by European rules than tax rates. Most importantly, there are no binding European rules on maximum rates. The member states remain free to increase rates in order to raise more revenue even though their choice of rate structures and minimum rates is subject to legislative constraints in VAT and excises taxation and to constraints from tax competition in corporate taxation and indirectly also in personal income taxation. The EU has not taken over tax policy making but despite substantive and procedural safeguards taken by the member states is deeply involved in it.

5. Conclusion

Our empirical study of the last 50 years of EU involvement in taxation has yielded a seemingly paradoxical result. On first sight, the adherents of the popular “no taxation” thesis are right: The EU does not have an income which even remotely resembles a tax. Over half a century, it has not managed to come closer to a tax-based financing which would have come from individuals and corporate actors and which would have created a strong link between the EU and these actors. On the contrary, its income has become ever more intergovernmental and dependent on member state contributions. Although the argument that the EU budget was too small to have a stustantial macro-economic impact has been made already three decades ago,[70] member states have prevented such a growth of the EU

[69] Sacchetto 2007, 5.

[70] MacDougall Report 1977.

budget, even after the creation of Economic and Monetary Union which has further strengthened the case for a larger EU budget. The authority of the EU to act in the field of taxation is narrowly circumstribed and includes only matters which might have an impact on the Internal Market. In addition, the unanimity rule has been maintained in the Treaty despite the ever more widespread use of qualified majority voting in other areas in order to prevent any enchroachements upon member state prerogatives in the field of taxation. While the right to raise taxes is among the foremost rights and achievements of democratic parliaments, the European Parliament does not have this right despite the strong increase of its powers during the last decades. It seems that the EU is not following the development path of the Western federal states of the 19th century which began as fiscally weak polities but managed to obtain their own federal power to tax and were thus able to draw on an independent financial resource. On a first glance, therefore, the EU is fiscally weak. It has no independent income from taxation, it cannot increase its own budget and use if for macroeconomic stabilization or redistributive purpose, and there is no fiscal link between the EU and its citizens.

All this has been claimed by the proponents of the “no taxation” thesis. While it is true, it is not the whole story. On the contrary, the EU is actively pursuing tax policy which is of a regulatory instead of a fiscal nature. The unanimity requirement of the Treaty has not prevented this increasingly activist stance as whitnessed by the constant growth of tax legislation. In addition, the European Court of Justice has used the Internal Market justification provided by the Treaty to develop its own dense set of tax case law. The crucial issue here is that these are cases of hierarchical decisions which circumvent the high consensus requirements which usually prevail in the Council.[71] As a result, the EU has no taxes of its own but strongly constrains and regulates the member states ability to raise taxes. The member states are still in possession of their monopoly of taxation but subject to numerous constraints from hundreds of legal provisions and ECJ rulings.

This has important consequences for our understanding of the EU multilevel system. First, the strong growth of the European regulation of taxation escapes the attention of those approaches who see multilevel

[71] See Scharpf 1999, 50-71 for an extended discussion of “negative integration.”

governance as a gradual power sharing across levels of government. On first sight, their assessment is correct: Each member state has a veto against the adoption of European tax legislation. This justifies the low score taxation receives on scales looking at the locus of decision-making.[72] But this focus on the sharing of decision-making authority suggests that low scores leave member states' tax policy authority intact. However, 200 pieces of tax legislation adopted in the last decade suggest the contrary. The low scores on the decision-making scale have not prevented the adoption of these measures. Once adopted, however, the unanimity requirement also makes a change in the existing tax legislation or its abolishment more difficult. The gradual view on multilevel governance also focuses on standard legislative procedures and leaves judicial policy-making aside. However, ECJ rulings are purely supranational measures without any member state influence and should hence receive a value of five on the Lindberg-scale. More than 400 rulings in the last decade point to the significance of case law in taxation. Far from being slowed down by autonomy-preserving decision-making procedures, taxation is characterized by a *combination* of intergovernmental decision-making with supranational case law, a combination to which Joseph Weiler more than 25 years ago has attributed much of the dynamism behind European integration.[73]

Second, our analysis of the fiscal structure of the EU also sheds some doubt on the second interpretation of multilevel governance in the EU which sees the EU as a regulatory polity. The regulatory polity view makes a distinction between efficiency-oriented, Pareto-improving regulation of a transnational European market and (re)distributional, symbolic, policing, military etc. functions of national politics. It is based on the classic liberal divide between politics and markets. Market-regulation is considered to be either highly technical (as, for instance, in the case of the testing of medical drugs or health and safety standards at the workplace) or serves to correct market failures (as in the case of competition rules). Because it explicitly avoids political issues relating to core state functions such as redistribution, education, policing or defense, it relies mainly on output legitimacy and can do with the weak democratic or input legitimacy of the EU.[74] Regulation in

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72 C.f. the works cited in footnotes 7 and 8.

73 Weiler 1981 and 1982.

74 For the distinction between input- and output-oriented legitimacy see Scharpf 1999. For

this sense is and can be unpolitical. But this is exactly the reason why the EU could develop into a mature regulatory polity. Its legitimacy basis is not sufficient for assuming core state functions.

At this point, the positive theory of the regulatory polity turns into a normative one which suggests that the EU should stick to its original mandate of creating a liberal transnational market and refrain from interfering into the political functions of the member states.[75] We do not criticise the normative implications of the regulatory polity model. Our argument here is that regulation in the EU has gone far beyond what was originally understood by it. While it does not itself levy taxes, the EU regulates the member states' ability to tax. Taxation provides a critical illustration of how the EU does not limit itself to market regulation but massively interferes with core state functions. The EU does not only regulate markets, it also regulates governments and politics.[76]

Both the proponents of the "no taxation" thesis and of the regulatory polity model are right – but only if seen together, their views capture what multilevel governance in the EU is about. The "no taxation" thesis is right because the EU does indeed not tax individuals or corporate citizens. It also has not police forces of its own, does not oblige children to go to school, has no army and no encompassing redistributive welfare system. It does not take away the core functions from the member states. The regulatory polity model is also right. But regulation is by no means restricted to technical detail or market failures alone. The Internal Market justification for legislation at the EU level has been interpreted very extensively not only by the ECJ but also by the member states and led to the creation of a huge body of European tax law.[77] European tax law comes in a highly technical guise which is dry to read and may be boring to many. This may explain why it has been overlooked by observers who merely focus on the visible revenue side of taxation and omit the regulatory aspect. But tax regulation is eminently political as it touches upon a core power of the state.

This view of the EU as a regulatory polity which we illustrated by taking

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a justification that there is no democratic deficit of the regulatory EU see Majone 1998.

[75] For a more extensive treatment, c.f. Majone 2005

[76] Schelkle 2009.

[77] A major treatise of EU tax law comprises more than 500 pages; c.f. Terra and Wattel 2005.

taxation as an example may be valid for other core state activities as well. It rejects the zero-sum logic that certain powers have either to be possessed by the European or by the national level, and that a gain of one level is a loss for the other. The EU is not in the process of acquiring the resources and powers which its member states have obtained in long fights until the 20th century.[78] The member states keep these powers but exercise them within a European regulatory polity which they cannot completely control.

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78 C.f. Zürn and Leibfried, 2005.

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Tables

Table 1: EU secondary tax legislation,[*] 1958-2007

	1958-1967	1968-1977	1978-1987	1988-1997	1998-2007
by tax area					
VAT	2	6.5	24	79	94.5[**]
Excise	0	7.5	15	30	65.5[**]
Corporate tax	0	0	0	2	3
Personal Income tax	0	0	0	0	11
Administrative cooperation and miscellaneous tax	0	6	2	9	25
by legal instrument					
Regulations	0	0	0	8	13
Directives	2	19	35	35	39
Decisions	0	1	6	77	147
by issuing institution					
Council	2	20	41	109	179
Commission	0	0	0	11	20
Total tax legislation	**2**	**20**	**41**	**120**	**199**

Source: Eur-Lex database, own calculations

Notes:

[*] Secondary tax legislation refers to binding legislative acts of the Council or the Commission concerning the national tax policy of the member states. Non-binding recommendations, opinions, etc. are not included. Also not included are binding acts concerning the customs code, state aid law or own resources.

[**] As some directives pertain to VAT and excises alike, for example directives on tax exemptions for individual travellers. They have been counted as 0.5 for each of these taxes.

Table 2: Tax jurisprudence[*] of the ECJ, 1958-2007

	1958-1967	1968-1977	1978-1987	1988-1997	1998-2007
by tax area					
VAT	1	17	33.5**	116	208
Excise and other indirect tax	2	19	49.5**	68	102
Corporate tax	0	1	2	8	46.5****
Personal tax***	1	2	2	12	54.5****
Administrative cooperation and miscellaneous tax	0	0	1	5	6
by legal subject					
Primary law	4	29	56	68	124.5*****
Secondary law	0	10	32	141	292.5*****
by type of procedure					
Preliminary ruling	3	32	64	158	340
Infringement (failure to fulfil obligation)	1	5	24	49	68
Other	0	2	0	2	9
Total tax jurisprudence	**4**	**39**	**88**	**209**	**417**

Source: Eur-lex database, own calculations

Notes:

[*] tax jurisprudence refers to judgements of the ECJ on the compatibility of national tax law and European law. Orders are not included.
[**] Some judgements apply to VAT and excises. They are counted as 0,5 against each tax.
[***] Personal tax includes income, wealth, and inheritance taxes.
[****] Some judgements apply to corporate and personal taxes. They are counted as 0.5 against each tax.
[*****] Some judgements refer to primary and secondary law. They are counted as 0.5 against each legal subject.