

Taxing Europe. The Case for European Taxes in Federal Perspective

by

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Foreword

This publication resulted from an invitation to Augstín José Menéndez to present his current work at the seminar Globaliseringsforum, arranged by the Globalisation Program at the Stein Rokkan Centre for Social Studies 12.10.2001. The two other authors were invited to comment on the paper that was presented at the seminar by Menéndez.

The publication comes out of the *Strategic Program for Research on Globalization and Internationalization: welfare, work, legitimacy and globalization*, at the Stein Rokkan Centre for Social Studies at Bergen University Research Foundation. This program is designed as a University of Bergen research network, and its primary area of activity is the study of changes in *welfare and labor market institutions* as they are played out in the debate on globalization and internationalization (see <http://129.177.180.14/globalisering/programnotat.pdf>).

Issues of distribution, regulation and fairness are central to the program, which incorporates research in sociology, political science, economics, history and philosophy. One basic premise for program research is that focusing on welfare and labor market institutions can provide important insights into other areas of society and that it can also shed light on other globalization issues, such as the status of the nation state and conditions for democratic governance.

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Taxing Europe. The case for European taxes in a federal perspective¹

Augstín José Menéndez

Introduction

Public finances, was once said, are the nervous system of the political community.² A well-drafted budget speaks clearly to its reader. *How much is spent and on what* and *how much is collected and from whom* are among the most defining questions in politics.

This paper contains two pleas for reform of the public finances of the European Union. Both arguments support the granting of a genuine and significant power to tax to the Union.

The public finances of the European Communities (later Union) have been highly contested. Section I of this paper aims at providing a reconstruction of the many conflicts which have determined the present shape of the EU budget. Instead of the rather extended *recit* that registers the shifts and changes of the attitudes of intergovernmental actors, the reader will find an analysis which focuses on two basic questions: (1) Which is the unit of tax payment; (2) Which is the unit of redistribution of goods and services? The candidates to be both units are the member states, the regions and individual citizens. A full-blown political community tends to target all three units. We can consider whether that is the case with the EU.

These new *reading* of facts renders intelligible the two complementary but distinctive arguments made in the paper. First, a *modest case* of reform is presented (Section II), aimed at transforming the way in which the European Union is financed, but not how much money and on what is spent. The proposal is supported by normative and prudential considerations. Financing European public expenditure by means of taxes would render more transparent to individuals the benefits and costs of the goods and services derived from the Union. And this would allow for a more permanent scheme of financing the Union. Second, an *ambitious case* is argued for (Section III); it builds on the *modest case*, but adds that further redistribution of

¹ A first version of this paper was presented at the *Transatlantic Seminar on Constitutionalism in Europe*, organised by the Universidade Nova de Lisboa at the Summer School in Arrabida.

² This metaphor was coined by Roman lawyers, and reiterated by Jean Bodin, *Les six livres de la République*, (Aalen, Scientia, 1977), p. 855; Edmund Burke *Considerations on the French Revolution*, (New York, P.F. Collier and son, 1909), paragraph 188 and Alexander Hamilton, John Jay and James Madison, *The Federalist Papers* (Harmondsworth, Penguin, 1987), p. 212.

economic resources across borders should take place, and that the unit of such redistribution should not be only member states and regions, but also individuals. The supportive arguments are once again both normative and prudential. On the basis of the existing degree of economic integration, it is claimed that European integration can only be rendered legitimate if not only market-making, but also market-redressing norms are adopted and implemented at the European level.³ Section IV complements the *modest* and the *ambitious* cases with some observations concerning which concrete taxes should be assigned to the European Union. Among the normatively acceptable solutions, one can select those that rank better in prudential terms. The cunning of reason can be said to consist in matching normative and prudential reasoning.

Finally, the paper dwells with the relationship between redistribution at the European and global levels (Section V). The case for European redistribution implicitly assumes that the European Union is not the final level of politics, but an intermediate layer between national and global politics. European redistribution fits into an argument for *cosmopolitan redistribution*. It is claimed that such argument is not only compatible, but reinforces the case for global redistribution, both by means of producing a theoretical and policy model and by creating a political dynamic in its favour.

How the European Communities have been and are financed

This section analyses the historical evolution of European public finances.

The cost of Europe has been met in very different ways all through the six decades of European integration. Transformations have been led by changes in the perception of what expenditures should be undertaken at the European level. To consider two clear examples. The move towards the establishment of the Common Agricultural Policy or the Economic and Monetary Union led to a major expansion of the action of the Communities, which resulted in an increase in the amount of economic resources to be channelled to the European budget. But transformations have been caused also by different perceptions of how the money should be collected. The Treaties Amendments of 1970 and 1975 aimed at substituting the system of national contributions by an autonomous system of own resources of the Communities. The endemic insufficiency of resources and the perceived unfairness of Value Added Taxation as the major source of European revenue led to a partial return to a system of national contributions after 1989.

³ As it is argued, the distinction between market-making and market-redressing norms is more pedagogical than actually useful when coming to terms with existing policy measures.

Such changes have led to different answers to two basic normative questions at the core of a system of public finance, namely which should be the unit of contribution to public revenue and which should be the unit of redistribution of economic resources⁴. In nation-states, such unit is typically the individual (or the household in *personal* taxes). However, regions are also the relevant units for certain purposes, such as *cohesion* transfers among poor and rich regions. In Europe, the resilience of national direct contributions and of regional and national policies leads to regions and nation-states as the main units of contribution and redistribution.

The original provisions

The original financial provisions of the three European Communities (the European Coal and Steel Community, the European Economic Community and the EURATOM) were rather fragmented.

The Paris Treaty granted a limited *power to tax* to the High Authority (later to become the Commission of all three Communities), reflecting the willingness to set such institution as an *autonomous* guardian of the market of these two raw materials. According to Article 49, the High Authority had the power to levy taxes on coal and steel production in order to finance the expenses of the Community (and to borrow money).

Expenditure was needed given the fact that the Coal and Steel Community was given the mandate to deal with the structural changes in the industries, something that was clearly considered would require combining market making with social policy. Until 1997,⁵ the Coal and Steel Community exerted regularly such power to tax, fixing tax bases and rates periodically, in view of its financial needs.

Articles TEC 200 and 201 (and the companion article 172 of the Euroatom Treaty) were quite different. They contemplated *national contributions* as the immediate source of revenue to the Community. However, Article TEC 201 and EURATOM 173 envisaged their replacement by a system of own resources once the *transitional period* was over, and the Customs Union and the common market were in place.

In the immediate aftermath of the entry into force of the Treaty, budgeting was rather complex. No single budget was established, but a plurality of them coexisted, depending on the nature of the expenditure. Revenue was earmarked for specific

⁴ On the relevance of considering which are the units of contribution and redistribution, see sections II and III.

⁵ The Treaty of Paris expired in 2002. Given the fact that the ECSC was expected to obtain revenue from non-tax sources sufficient to cover its expenditures, it was decided to set at 0% the rate of the taxes collected by the ECSC. See *Décision 2749/2000/ECSC* of the Commission, OJ L 318 of 16.12.2000, p. 13.

purposes and specific ratios of contribution were assigned to each policy expenditure. Thus, national contribution rates depended on the nature of expenditure.

This can be illustrated by considering the ratios to which member states contributed to the budget of the Commission (Art. 200, section 1), the Budget of the European Social Fund (Article 200, section 2) and the Development Fund⁶.

Table 1. Some ratios of the original national direct contributions

Country	Commission budget	Social fund	Development fund
Belgium	7.9	8.8	12
France	28	32	34.5
Germany	28	32	34.5
Italy	28	20	6.9
Luxembourg	0.2	0.2	0.1
Netherlands	7.9	7.0	12

A false step towards financial autonomy

The first major attempt to replace national contributions by direct sources of revenue to the Union was undertaken in 1964. The first years of the Community were characterised by a relative success in the implementation of the goals of the Customs Union and the single market. With the Customs Union to become a reality ahead of schedule and President De Gaulle using his leverage to substantiate the Common Agricultural Policy, the Commission felt the time was ripe for the development of Article TEC 201 and EURATOM 172. A provisional Regulation had been approved in January 1962 in order to meet the costs of the implementation of the common agricultural policy. Such Regulation had to be renewed each and every year.

The President of the Commission, Walter Hallstein, supported a move towards establishing a more stable Regulation, to be in force until the need of the transitory period. As the customs union was about to become a reality, the Commission proposed to substitute national contributions for the proceedings of the customs duties, thus ensuring the financial autonomy of the Communities. His proposal was double. On the revenue side, the proceedings of agricultural levies should be payable direct to the Community from 1967, while the payment of industrial import duties to the Community should be phased in over some few years. This implied shifting the unit of contribution to the cost of Europe from member states to individuals. On the budget side, it was argued that it would be necessary to grant the *power of the purse* to the Assembly (later Parliament), weakening the *veto* position of Member States, even

⁶ This was set up by an Implementing Convention and implemented by Order n. 5 of 2.12.1958, OJ 33 of 31.12.58, pp. 681ff.

big member states.⁷ This would have also given further leverage to the European Commission, which would have a power of initiative concerning the definition of the financial needs of the Communities.⁸ This would have assimilated the European power to tax to national power to tax, even if limited and constrained in view of its purpose. That might have signalled a progressive shift in the unit of redistribution from member states to individuals.

Hallstein was an open partisan of using integration through law to «force history». The move implied simultaneously enhancing economic integration and reforming in structural terms the Community institutions⁹.

As it is well-known, this resulted in the Luxembourg crisis, which sidelined the transfer of actual power to tax to the Communities and thus avoided dealing with the budgeting powers of Parliament¹⁰.

The real move towards financial autonomy

The empty chair crisis did not prevent the launch of Common Agricultural Policy, but it was determinant of the decision to finance it through direct national contributions.

The mandate of Article TEC 201 to establish a system of own resources of the Communities was not reconsidered until 1969. By that time, not only De Gaulle had left the French Presidency (in April), but the Customs Union had been completed and the need for a certain degree of harmonisation of indirect taxation had become an urgent matter, as different levels of indirect taxation and intransparent ways of collecting it had become the remaining major distortion to the common market.

The Hague Summit resulted in the reaffirmation of the principle envisaged in Article TEC 201, namely, that the Communities should get autonomous sources of revenue. Financial autonomy of the Communities was once again a desirable goal.

⁷ Richard McAllister, *From EC to EU*, (London, Routledge, 1997), pp. 32ff.

⁸ Proposal submitted by the Commission to the Council on 31 March 1965, 'Financing the Common Agricultural Policy', Bulletin EEC, Supplement 5, (European Commission, 1965), pp. 2711. See also Hellen Wallace, *Budgetary politics: the finances of the European Communities*, (London, George Allen and Unwin, 1980), p. 52.

⁹ Bino Olivi, *L'Europe difficile. Histoire politique de l'intégration européenne*. (Gallimard, Paris, 2001), pp. 123ff.

¹⁰ Does Moravcsik take *that* seriously the empty chair crisis? (Cf. Andrew Moravcsik, *Choice for Europe*, (Ithaca, Cornell University Press, 1997), p. 196: «It is striking how *little* of what De Gaulle sought he achieved and thus how little the crisis diverted the longer-term evaluation of the EC») and p. 184: «In the early 1960s, it was above all Gaullist France that insisted on moving beyond long-term contracts, initially favoured by France as less 'supranational', to a more centralised CAP managed and financed in large part by Brussels-based officials. This involved a system of value-added taxation centralised in Brussels, a supranational power of taxation».

There was a need of both establishing the «own resources» of the Communities and a new budgetary procedure to decide on how the collected money should be spent.

A first step was taken in 1970. A Treaty amendment established the basis of the own resources system¹¹. All customs duties, all agricultural levies and a percentage of harmonised VAT base (1%) were to be transferred to the Communities. The European Parliament was given a certain major role in the budgetary process.

In substantive terms, this might look as not very different from Hallstein's proposal. However, in the elapsed time it had become clearer that customs tariffs and agricultural levies could not be regarded as a stable source of revenue, as the European common market making effort took place in the context of international efforts at reducing customs levels. The success of the CAP was also reducing the food dependency of the EU, and thus, also the yield of the agricultural levies and duties. Moreover, the *autonomy* of Community institutions was rather curtailed, as financial decisions were clearly linked to existing financial commitments.

The agricultural levies and sugar duties were transferred immediately, while the customs duties on trade with third countries were progressively transferred from 1970 to 1975. This resulted in a progressive phasing out of the direct contributions made by Member States.

The 1975 Treaty amendment reinforced the powers of the European Parliament, as it was given the final say on items in the budget defined as non-compulsory expenditure, the right to reject the budget in its entirety and the sole right to discharge the budget. As it had happened in national political processes, the Parliament has tried to use such power of the purse to expand its competencies on other policy fields, something that resulted in a series of institutional confrontations in the 1980s.

The VAT resource could not be implemented until 1979 as only in that year agreement was reached on how the harmonised VAT base was to be calculated. Despite the fact that a series of Community directives establish the basic framework under which national legislators must establish the VAT, there are still marginal and not so marginal differences concerning the tax rates and the tax bases. If the VAT to be transferred to the Communities will be calculated as a percentage of the actual VAT yield in each member states, those states imposing higher VAT rates and granting less exemptions would have to contribute more than those opting for lower rates and exempting certain transactions from the VAT base. Thus it was necessary to establish an ad hoc and fully harmonised definition of the VAT base for the purpose of determining national contributions to the European budget.

¹¹ See the conclusions of the Luxembourg Council, 21st April 1970.

It must be noticed that with the actual implementation of VAT as the *third resource* of the Communities, not only a certain degree of financial autonomy was achieved, but also there was a clear shift on the unit of contribution to the cost of Europe. Even if not always conscious of it (one can say mostly not conscious of it), individual citizens became the contributors to finance European public policies. The limited powers of the European Parliament (which was granted only in 1975 a final say on non-compulsory expenditure items in the budget) limited the shift of the unit of redistribution of the goods and services provided by the Communities.

The looming crisis: insufficient means, increased ambitions

The move towards financial autonomy was to prove rather controversial, as the actual operation of the system came under severe criticism. First, the system proved to be insufficient in practical terms. Autonomy was a fancy word to be contrasted with the endemic insufficiency of resources to match the increasing commitments of the Communities. More resources might be needed to run the programs that were within the scope of action of the Communities (this was highlighted in the Commission's report *Financing the Community Budget: The Way ahead*). Second, the system was perceived not to be fair in *distributive terms*. Great Britain, to whom agricultural policy brought about meagre income, strengthened its arguments for getting a rebate. It is rather interesting to notice that the argument revolved around two basic hypothesis. One, that *member states* as such should get a fair pay back for the money they contributed (something that was coined in Eurojargon as the *juste retour*). Second, that VAT as a source of revenue was unfair because the less well-off members would have to pay a relatively higher share of the cost of Europe. That is so for the simple reason that the richer a country, the lessere percentage of national income that goes into consumption. The UK was not only successful in getting rebates, originally through specially targeted expenditures from the Union budget, later on as an actual rebate of the money contributed to the common budget, but also in framing the terms in which European public finances will be discussed for the next two decades.

The turning point came in 1988, as the *financial crisis* of the Communities, namely the chronic insufficiency of means to achieve goals, was sorted out by means of introducing a fourth *own resource*, namely, a national contribution calculated according to the national GDP. This implied a first reversal of shift towards the individual as the unit of contribution to the European budget. The second major reversal came in 1993, as it was decided to reduce the revenue obtained through the VAT, something which was to be compensated by an increase of the fourth revenue, calculated on the basis of the national product.

Such shift was quite paradoxically reinforced on the expenditure side by the increased means at the disposal of the Delors Commission. The new article TEC 130 on 'economic and social cohesion', introduced at the Single European Act was taken by the Delors Commission as a mandate to draft the *Report on the Financing of the Community Budget*. The so-called Delors I was agreed in February 1988, and led to a sizeable increase in the resources of the budget, which were to be spent in structural policies, which implied to redistribution targeted to the poorest regions. The Maastricht Treaty led to the so-called Delors II, which was anticipated by *From the Single Act to Maastricht and Beyond: The Means to match our ambitions*. The Commission proposed a budgetary strategy organised around six categories of expenditure. It envisaged a clear increase of redistributive expenditure, through further structural expenditure, which included from then on the so-called cohesion funds.

The present system of finance

The present system of European public finance is the result of the agreement reached under the German Presidency in the first semester of 1999. The political agreement was translated into a Council Decision in September 2000¹².

The Decision establishes transitory arrangements to move from the present system, in which Value Added Tax stills account for most of the revenue of the Union, to the system to be in force from 2004, in which the fourth resource, namely national contributions calculated as a percentage of the Gross National Income (a refined variant of the Gross National Product) is to account for most of the active side of the European budget.

The system of own resources keeps on being structured on four main headings:

- 1) Agricultural levies and duties
- 2) Common Customs Tariffs
- 3) A percentage of the Value Added Tax, calculated on the basis of the common harmonised basis
- 4) Transfers from member states calculated on the basis of the Gross National Income.

The revenue derived from the core own traditional resources, that is, agricultural levies and duties and customs tariffs, is reduced. That is so because member states are entitled to retain 25% of the yield of such resources on account of collection costs, from a mere 10% under the previous arrangements.

¹² Council Decision 2000/597/EC, Euratom on the system of own resources, of 29 September 2000, OJ L 253 of 07.10.2000, pp. 42ff.

Further changes concern the third and fourth chapter of the own resources system. The rate to be applied to the harmonised common base of VAT is to be reduced from the actual 1% to 0.50% in 2004, with a transitory rate of 0.75% for 2002 and 2003. The loss of revenue is to be compensated through an increase of the fourth resource. Further changes concern the alleviation of the share of the British compensation supported by the four net contributors to the European budget, that is, Austria, Germany, the Netherlands and Sweden.

Table 2. VAT: first up, then down you go

YEAR	VAT RATE
1983	1.00
1984	1.14
1985	1.40
1986	1.40
1987	1.40
1988	1.40
1989	1.40
1990	1.40
1991	1.40
1992	1.40
1993	1.40
1994	1.40
1995	1,32
1996	1,24
1997	1,16
1998	1,08
1999	1.00
2000	1.00
2001	1.00
2002	0.75
2003	0.75
2004	0.50

Source: EC Comission

The European Union obtains a tiny amount of income from the personal tax charged on its own personnel.

According to Article 13, second paragraph of the Protocol on the privileges and immunities of the European Communities of 8 April 1965, officials and other servants of the Communities shall be «exempt from national taxes on salaries, wages and emoluments paid by the Communities». The first paragraph establishes that they should be liable to be taxed on such bases by the Communities itself. Regulation

260/68¹³ established the basic framework for the Community income tax. Article 3 establishes the *tax base* and Article 4 determines the tax rates.

These provisions are not relevant on account of the income obtained. As it has been frequently indicated, the Communities have a relatively tiny number of civil servants of its own, which explains why the European income tax provides only 0.XX % of the yearly revenue of the Union. But such tax is relevant on three accounts. First, that the personnel of the Communities is exempted from national tax but not from tax at such, and is given a treatment far less *beneficial* than diplomats in most member states. This points to the willingness to avoid any kind of special treatment. Second, the introduction of a progressive scale is also relevant, and reinforces the first argument. Third, it might be seen as been underlied by a basic principle: those who benefit most from the Union should be paying taxes to the Union. In the case of civil servants, of Eurocrats, *benefit principle* can act as determinant of the jurisdiction to which the tax should be paid, and at the same time does not preclude that tax liability is calculated according to the principle of progressiveness.

Regarding the European Coal and Steel Community, the Commission decided to set the levy rate at 0% from 1998, as the provisions entered in the ECSC balance sheet at 31 December 1997 were deemed sufficient to maintain the ECSC's budgetary activity at the appropriate level until the expiry of the Treaty. Most of the resources therefore derive from the 'net balance' from annual financial operations, in particular interest on loans from own resources, investments, reserves and provisions entered in the ECSC balance sheet, cancelled commitments and miscellaneous revenue. Finally, the provision for financing the operating budget which was set up as a precautionary measure in 1997 balances revenue and expenditure in the ECSC budget.

The Prudent Case: Modesty

The modest reformer (call her Modesty) argues that it is time to reconsider the revenue side of the European Union budget. It assumes as given the present extent and shape of expenditure.¹⁴ To *pay* for such public services and goods, it argues that a *proper* system of own resources of the Union, in the form of taxes decided by and payable to the Union, should substitute the present system. The case of Modesty is,

¹³ Regulation (EEC, Euratom, ECSC) No 260/68 of the Council of 29 February 1968 laying down the conditions and procedure for applying the tax for the benefit of the European Communities, OJ L 56 of 04.03.1968, p. 8.

¹⁴ It does so for the time being. It is neither incompatible with an *ambitious* reform (on the contrary, it can be seen as a necessary step to be taken within a larger framework of reform) nor it claims to be ecumenical regarding the shape and extent of the Union's finance. The modest reform might (or might not) spark a debate conducive to the ambitious proposal.

therefore, to change the unit of contribution to the European Union budget, from member states to individual citizens.

At the end of the day, all taxes are borne by individuals. However, whether taxes are directly aimed at burdening individual ability to pay or not makes a difference¹⁵.

This is relatively easy to show in the case of European public finances. As we have seen, the argument of *fairness* has been rather successful in undermining the role of VAT as a source of European revenue. VAT was said to be *regressive*, because the less well-off, having a higher propensity to consume, will devote a higher proportion of their income to consumption. VAT needed to be progressively replaced by a *fairer* different resource. Even if the argument was applied to the aggregate figures of each member state, one could notice that part of its attractiveness was associated to the well-known *individual* regressiveness of VAT, characteristic of most *sales taxes*¹⁶.

As we have seen, the actual fourth resource is a national contribution *proportional* to the aggregate national income. As things stand, this means that Germany would pay more and Portugal less, to consider only two cases. However, German citizens will pay as *Germans*, and Portuguese citizens as Portuguese, not as better off or less well off citizens, something that does not guarantee that the burden will be distributed fairly across European citizens.

Redressing unfairness at the *national level* is no guarantee of redressing it at the *individual level*. German citizens as *Germans*, no matter their own level of income, will have to bear a given tax burden at home in order to pay for German national contribution. To the extent that no specific tax is earmarked as the *European tax* within the German system, the *distributional* pattern of the additional tax burden would depend on the *distributional pattern* of the German tax system as a whole. This might be fairer or less fair than the distributional pattern of VAT. Even if, as we can quite safely assume, the *distributional pattern* might be fairer than that of VAT within

¹⁵ Of course, one could always argue that exactly the same distributional pattern could be achieved by two tax systems, one expressed as a burden on nation-states and the other on individuals. This would be rendered easier by the introduction of national taxes earmarked as means of collecting the *national quota* of the European budget. Leaving aside the fact that it is clearly easier to target individual ability to pay *directly* rather than *indirectly through national contributions*, Modesty can still argue that the symbolism of individual direct contributions tilts the balance in favour of her argument. I am grateful to Alexander Cappelen for indicating me the need of clarifying this point (see his comments).

¹⁶ Sales taxes could be rendered progressive if they are combined with a tax on aggregate spending applied at progressive rates. This seems to be the argument made by Edward MacCaffery, 'Real Tax Reform: The case for a progressive consumption tax', *Boston Review*, vol. 25, available at Available at <http://bostonreview.mit.edu/BR25.5/mccaffery.html>.

German taxpayers, this does not mean that the tax can be regarded as fairer in European terms. After all, it still can be the case that, given the same level of income, a Portuguese citizen will have to contribute less than a German citizen.

This can be illustrated more clearly with an extreme counterfactual case. Imagine that Germany and Portugal have the same aggregate national income, but in Germany all income is distributed equally while in Portugal 99% of the income is concentrated on the hands of 1% of the population. If the *fourth* resource is calculated by reference to the *national* level of income, Germany and Portugal will be allocated the same burden. If it is calculated on the basis of individual ability to pay, the richer 1% of the Portuguese population will have to bear a considerable part of the tax burden, in the aggregate higher than that of all Germans taxpayers together.

The sceptical can still argue that such different pattern of *paying for Europe* is part and parcel of legitimate differences across member states. Why should not nationals decide which distributional pattern they prefer to pay for Europe? Modesty's counterargument is clear: if the cost of Europe reflects goods and services which are *European*, which benefit all Europeans, then we should consider the relevant distributional pattern across Europe. Modesty is ready to substitute the raw national income indicator for another one that takes into account disparities in purchasing power across Europe. But she insists that the cost of European public goods and services should be distributed fairly among Europeans, and that for such a purpose, *national borders* should not matter¹⁷.

Under the heading *own resources* one finds what are perceived and mostly are transfers from national coffers to the Union budget. Modesty argues that this is unacceptable on three accounts. First, it hides from the scrutiny of citizens the positive and negative effects of Union's policies. According to her account, this might explain a good deal of citizens' apathy towards the Union, reflected in the poverty of debate before and the lower turnout in elections to the European Parliament¹⁸. Second, the present system reinforces the nation-state and regions (that is, collectivities) as the exclusive *unit* of distributive justice within Europe. This runs against the thickening of common interests shared by European citizens and against the increasingly felt direct impact of Union policies. Moving towards direct financing through taxes will open up for the individual as the proper unit of distributive justice

¹⁷ This is in line with a basic principle of Community law, namely, the principle of non-discrimination on the basis of nationality. See Article TEC 12.

¹⁸ If hard-boiled realists argue that people are not that interested in politics, Modesty counterargues that they are interested in interesting things. As national politics becomes less interesting (perhaps due to the technocratic language of politicians, perhaps due to their lack of vision, perhaps due to other reasons), people become less interested. European politics is even more remote, their participation seems to them to matter less, therefore they care less.

within Europe. Third, the present system of transfers is too rigid, and stands in the need of renegotiation every given number of years (according to actual practice, five). Moreover, it leads to a negotiation style based on the gains and losses to the concrete member state. This results in rigidity and long negotiations. Moving towards a system of direct financing through taxes would allow a double proceduralisation. On the one hand, it would allow to decide under a limited veil of ignorance. Who will be paying what would depend on the economic performance in the future. On the other hand, it would render clear that not states, but the better off individuals, those who benefit more from the existence of the European Union, would be picking up the bill. This would also increase support for the arrangements.

The Expenditure Side not questioned

Modesty argues for a radical overhaul of the present *revenue* side of the European budget. It takes as granted that the European Union will keep on having a budget of more or less the same size as the present one (around 1,3% of European income). Modesty might have some observations to make to Ambition, concerning what kind of logic underpins the present expenditure (more specifically, to show that it already contains an element of redistribution across borders). But her main plea for reform is not to expand or reduce the Union budget, but to increase the *legitimacy* and *expediency* of the financing the Union. The way to do that is by means of obtaining most of the revenue through the direct collection of taxes at the European level. The *modest case* is, at least in the short run, agnostic towards the level and kind of expenditure conducted at the European level. It only insists that *direct collection of taxes* is more correct (in normative and expediency terms) than *transfers from national treasuries*.

The arguments in favour of taxation

The modest case boils down to a combination of two general arguments apply simultaneously to the European Union.

The arguments are the following: (1) taxes are by far the best means of financing public expenditure; this is so both in normative and prudential terms; (2) taxes should be collected by the level of politics which mainly proceeds to turn such revenue into a series of public goods and services.

When applied simultaneously to the European Union, these two arguments call for the financing of European expenditure through taxes directly payable to the Union. This implies that financing the Union through contributions coming from national treasuries is rather inadequate.

Normative considerations

The main argument is that the increased direct impact of European policies and actions on individual citizens should come hand in hand with a direct system of financing the Union. Democracy does not only call for *no taxation without representation*,¹⁹ but also for *no expenditure without taxation*. Taxes are not only a cost to democracy, but also a means to democracy. They ensure knowledge about the actual goals of public action, which can then be open to full democratic scrutiny.

Paying for the Union through taxes collected by the Union is thus to be preferred on *democratic* grounds. Modesty argues that such a move would increase the visibility of the pros and cons of the activities of the European Union. This would hoist consciousness of the actual depth of the impact of the Union on the lives of individuals. The result would be a renewed increase on the European political process. In the standard, minimalistic view of democracy, more salience would lead to more electoral participation, to a bottom-up push for the constitution of real pan-European political parties, which would argue in terms of cross border issues and common interests. In a more deliberative, participative understanding of democracy, salience would lead to the interlocking of European public spheres and political movements, leading to an increased realisation of the need to feed the European political process with democratic input.

Moving towards a European system of taxes to finance the Union's budget would have the indirect and cunning result of increasing the degree of participation in the European level of politics, and thus, increase the quality of European democracy.²⁰

To this, the sceptic can still argue that member states, not individuals, should be the units of contribution to finance the European budget. But, leaving aside the argument that *we have done it that way*, why should this be so? First, the benefits of integration are not circumscribed to what is got through the European budget (what comes back, so to say). The whole argument of the *juste retour* is based on a bogus analysis of the costs and benefits of European membership. The German economy, to put just a clear example, has benefitted considerably from the Common Market.

¹⁹ Advocates of deliberative or discursive democracy could actually adapt the motto and claim «no taxation without deliberation», meaning a more sophisticated and more open to participation tax legislative process.

²⁰ Modesty is not to be confused with Shyness or Reaction. In her view, the main problem for democracy is the actual lack of participation, not the *overparticipation* of individuals. Modesty stands closely, even if critically, with bottom up activists (cf. Carlos Santiago Nino, *El presidencialismo y la estabilidad política en la Argentina*, (Buenos Aires, Centro de Estudios Institucionales, 1991), pp. 17?18, against organic intellectuals. The argument that democracy enters into crisis through excessive participation is to be found in Michael Crozier, Samuel Huntington and Joji Watanuki, *The Crisis of Democracy* (NewYork, New York University Press, 1977).

What Germany as a unit obtains from the Union clearly exceeds the services and goods directly delivered to German nationals by the Union. If we want to apply correctly the principle of *juste retour*, it would be necessary to include more sophisticated statistics. Second, *national* debates are clearly permeated by the idea that there are losers and gainers as a result of the process of integration. If it would be possible to make such transition also in order to device rules for financing the Union, it would be possible to *erode* the purely accountancy and nationalistic reference to gains and losses. In such a way, the *commutative* or *benefit* analysis would be transferred from nation states to individuals, and an opening towards more openly *redistributive* concerns would arise.

Prudential considerations

European taxes as a means of financing the Union's budget is also to be supported on prudential grounds.

Modesty argues that the present system of financing has been characterised by a permanent struggle to adapt means to ends. The chronic instability of the system was rendered crystal clear by the repeated financial crisis of the 1980s. The agreement reached in Fointenebleau in 1988 increased the means at the disposal of the Union, but at the price of renouncing much of its financial autonomy. Permanent crisis was substituted by periodical crisis, erupting shortly before a new quinquennial financial perspective must be negotiated. The increased dependency on the fourth resource, namely, the direct transfer calculated as a proportion of an economic indicator that refines the Gross National Product, implies a need to establish new arrangements every number of years. The increased weight of this new type of national implies, as we have said, that *the nation-state* is the correct union of *contribution* to the European budget. It does not take much ingenuity to push the companion claim that the nation-state (or at most, its regions) should be regarded as the adequate unit of distributive justice in Europe. One should not be surprised if quinquennial negotiations revolve around the adequate correspondence between the national share and the national benefits, in the *quid pro quo* of the European budget for each member state. The double role of the nation-state as unit of distribution of costs and benefits leads to a clear stalemate and renders negotiations more difficult.

Things would be different if the budget would be financed through taxes. On the one hand, this would imply shifting the unit of financing from the nation-state to individuals. As it has just been argued, this would allow to make it clear that all citizens, no matter of which nationality, would be paying for Europe according to their *ability to pay*, measured in specific terms by the concrete tax or taxes collected at or on behalf of the Union. As suggested in Section IV, European taxes should be

tailored in such a way that it will become intuitive that those who are better off and/or are benefiting more directly from the existence of the Union are those who are picking up most of the bill. In itself, this would lead to a *proceduralisation* of the debate. When deciding how to pay for Europe, the key question would not be whether or not one is a national, but whether or not one does well in economic terms. The latter criterion is not only more flexible (in the sense that it is more probable that one would not have the same economic capacity all through her life than that one would not have the same nationality all through her life), but also more appealing when it comes the time to distribute burdens and profits. On the other hand, it would render negotiations easier, as negotiators could base their bargaining position on their ideological stand instead of their *national* stand. If the negotiation is framed in such terms, the divide should be ideological, not national.

At the end of the day, Modesty could still face a further counter-argument. It would be the following²¹. It might be true that the common interests of Europeans have been thickening and that for many purposes Europe has become a relevant community of risks, which requires a companion community of insurance. However, it is also the case that this is taking place at a time at which individuals are increasingly reluctant to assume collective obligations. The willingness to spontaneously comply with tax obligations, even national and local ones, is on the decrease. This can be realised by considering the episodes of tax resistance and the pervasive rise of the black economy, to refer only two indicators. If that is so, one could guess that widespread resistance would be the reaction to a more foreign and distant obligation to pay, imposed at the European level. Even if Modesty's case might be right *in theory*, it might not stand much of a chance *in practice*.

Modesty is aware of the reluctance of European citizens to pay any taxes. However, her case is not a naïve one. She estimates that the looming tax crisis is a *legitimacy* crisis. Individual citizens are increasingly unsatisfied with the actual pattern of distribution of taxes. A complex causal chain has led to a situation in which the promise of progressiveness and fairness is not redeemed by actual practice, as those obtaining income from mobile economic factors, such as capital, are able to place themselves at the margins of the tax system. Some decisions adopted at the European level, such as the concrete interpretation given to the free movement of capital since the late 1980s, are at the root of the problem. Having said that, Modesty claims that the *legitimacy crisis* will not be overcome by means of simply relying on national or local taxation. As will be argued in Section IV, the European level of politics is the only one with the actual capacity to tackle the main source of the problem. The co-ordination of national tax administrations at the European level

²¹ I am very grateful to Rune Ervik in this point (see his comments).

would re-empower them to tax those tax bases, such as capital income, that now can escape the national taxpayer.

The tax mix to finance the Union

Modesty claims that many different combinations of taxes are compatible with her argument. She is not especially favourable to this or that tax (or taxes) as the ones to be collected by or in the name of the European Union.²² Such question requires being debated in detail, but can be distinguished from her present argument, which must be settled before.

Having said that, Modesty shares with Ambition some points concerning the main features that European tax(es) should have. The reader will find such considerations in section IV of this article.

The Bold Case: Ambition

The ambitious reformer (call her Ambition) argues that it is time to reconsider the revenue and the expenditure sides of the European Union budget. She sympathises with Modesty, but considers that the latter is only willing to go half way. What is wrong with the present system of European finances is not only how the money is collected, but also the extremely modest amount that is collected and spent.

Her argument is both normative and prudential. In normative terms, Ambition starts by making an immanent argument, namely, the present system of European public finance already implies that it is necessary to purchase legitimacy credit to the common market through redistribution across borders. We can stand on such implicit assumption and just explore where it should lead us. But she does not stop there, and produces a second argument that provides the normative reasons to underpin such assumption, whether or not one agrees that it is already implicit in Union law. She openly argues in favour of the claim that the legitimacy of the European project requires more intensive redistribution of economic resources at the European level. Moreover, the unit of such redistribution should be not only nation-states and regions, but also individuals. To *pay* for such extended set of expenditures, it argues that a *proper* system of own resources of the Union, in the form of taxes decided by and payable to the Union, should substitute the present system. Such

²² Her scheme does not imply arguing in favour of an independent Tax Agency being created at the European level. The tax could be collected and enforced by national tax administrations. Modesty can add that, contrary to what is usually assumed, they have become Europeanised and will become even more so in the coming future. The implementation of the forthcoming directive on the taxation of savings income would render clear that national tax administrations are to take care not only of national financial interests, but also of those of all Member States.

taxes should establish a direct link between citizens and the Union. Those individuals who have a sufficient economic capacity should pay for the Union as individuals, not as subjects of a given nation-state. Her normative argument is complemented by a prudential one, which considers the sources of stability within the European Union. On Ambition's reading of European history, market making has only been successful and led to a peaceful coexistence when it has come hand in hand with redistributive measures at the same level at which markets were being created. In her analysis, redistribution is the price of European civilisation.

Ambition is conscious of the difficulty of her task. The argument that redistribution should take place at the European level is somehow counterintuitive to many European citizens,²³ used as they are to associate welfare state with nation-state. She wants to avoid making her task even harder by making two caveats. First, she does not aim at eliminating or getting rid of redistribution at the national level. Her aim is to create an interlocking system of redressing inequalities which protects national arrangements from pressure and at the same times ensures the overall maintenance of equality. Second, her argument in favour of considering the individual as one of the units of redistribution within Europe does not aim at disregarding other units of redistribution. Regional and cohesion policies aimed at guaranteeing a homogeneous level of provision of public goods and services are quite compatible with the transfer of economic resources from and to individuals to ensure other goods and services. As a matter of fact, such combination is quite frequent within member states themselves, both at the regional and municipal level.

The normative reasons

The immanent acceptance of redistribution

The European Union is already into redistribution. A major share of the actual expenditure of the Union goes into policies which have as a clear effect the redistribution of economic resources across borders. Ambition accepts that this is not the usual terms in which Union policies are analysed, but she claims that this is the case. Moreover, that this has been the case not only since regional policies became part and parcel of the goals of the Communities, after the accession of the United Kingdom, Ireland and Denmark, or after the move towards Economic and Monetary Union in 1991, which was coupled with a generous provision of cohesion funds to Ireland, Spain, Greece and Portugal, but since the very beginning of European integration.

²³ Ambition is keen to notice that this association is, as a matter of fact, stronger the higher the National Gross Product is. She wonders whether citizens internalise the national perspective even if it is against their own interest.

The Spaak Report already hinted at the fact that the forthcoming Economic Community should aim at sorting out the basic economic problems that characterised the six, namely, their productivity gap with the United States and the lack of technology. Attaining such objectives will not be painless, and would require combining market making with social policy. Thus, the need of an investment bank (*European Investment Bank*, which started operations in 1958) to support economic development and adjustment, and the need for a *Social Fund* (started operating in 1960) aimed at improving the quality of the European labour force.

Despite what is usually assumed, the Rome Treaty is not exclusively about negative integration, but it corresponds to a logic of market-making, within which different balances can be struck between different interests and values. The principle of non discrimination on the basis of nationality is usually assumed as a concession to Italy, which by then had all the prospects of remaining a nation of migrants to other member states. The principle of equal pay for equal work between men and women is said to have been included out of the fact that French legislation already implemented it, and the lack of such norm at the European level would be detrimental to French competitiveness, in a way. The European Social Fund, already enshrined in the 1957 Treaty, is regarded as a petty side agreement, something which extends to the European Investment Bank. These measures are clearly short the mark of a proper social policy, and even further from anything coming closer to redistribution. However, they clearly contradict the argument that the European Communities, later the Union, were to be regarded as a matter of neo-liberal economic integration.

The Common Agricultural Policy, and especially the Agriculture Guidance and Guarantee Fund, also corresponds, in a limited sense, to this kind of logic. One needs to take into account that at a time at which the percentage of the population which engaged into agriculture was still high, lifting the revenue of farmers was a basic part of any strategy aimed at social cohesion. The Financial Instrument for Fisheries Guidance was established following a similar logic once the Fisheries policies of the Communities was developed.

The first enlargement might be considered as revealing this redistributive component of Common Agricultural Policy, to the extent that it was felt necessary to find some equivalent measure for those countries (such as the United Kingdom) for which the CAP did not play sufficiently this role. Thus, the European Regional Development Fund was established in 1975.

The Single European Act, which is rightly seen as an essential step in terms of building a common market, does also reflect a more nuanced logic, to the extent that it incorporates to the Treaty a specific title on «Economic and social cohesion». This is

once again a limited concept, not corresponding to a full-blooded redistributive policy, but one indicating a different kind of logic at play.

The Treaty of Maastricht made of economic and social cohesion an objective of both the Communities and the Union. The actual move to Economic and Monetary Union reinforced the trend as it resulted in the creation of overtly redistributive cohesion funds.

Moreover, there are specific institutional mechanisms, especially within the framework of the Economic and Monetary Union, which imply a further Europeanisation of tax policy.

Let me refer to you three examples of what I am saying.

On the one hand, Economic and Monetary Union leads to the characterisation of national economic policies as a matter of «common concern»²⁴. This is not just a rhetorical statement. In the coming years, we will become used to the annual publication of «broad policy guidelines» by the Community Chancellor of the Exchequer, to use a British expression to design a European office. This year, such guidelines were published April, 11, and included the recommendation of «reducing the overall tax burden, especially on low-wage labour and to improve the efficiency and transparency of tax systems, especially through widening the tax base, reducing tax rates and ensuring appropriate enforcement procedures». In the related field of public expenditure, the guidelines advice Member States to «achieve budgetary positions clearly below the object set in the updated stability and convergence programmes». It is quite clear that this is a very ambitious set of recommendations. I am not sure that the reduction of the tax burden is a *neutral* and *scientific* economic truth, and I am even less sure that making income taxes flatter is something which is likely to be swallowed by all Member States. But what I wanted was just to indicate to you that mechanisms of aligning tax systems are already at work, implicit in the practice of setting broad policy guidelines.

On the other hand, the third stage of Monetary Union, which has been entered by a number of Member States, implies the setting up of a Economic and Financial Committee, with a plurality of tasks assigned to it, including the keeping under review of the financial and economic situation of the Member States²⁵.

Finally, it has become quite well known that Member States which have joined the Economic and Monetary Union shall avoid excessive government deficits. As things stand now, if the deficit goes beyond 3% of the national product, the Member State will be put under the monitoring of the Council and could be fined²⁶.

²⁴ See ex Article TEC 103, now TEC 99.

²⁵ See Article TEC 114, section 2.

²⁶ See Article TEC 104, sections 1, 8 and 11.

Ambition is eager in finding instances of redistribution. But her claim is not just a catalogue, but is based on the actual implications of such a catalogue. First, Ambition's argument cannot be simply defeated by simply arguing that redistribution is better left to Member States, that it is not a competence of the Union. The series of redistributive policies that this is not the case. If one challenges Ambition on the matter of *competence*, one should be ready to challenge the present policies of redistribution as well. Second, Ambition's case aims at *redistributing*, but doing it openly, and therefore, better. One can consider the present policies, make sense of them, and try to determine which are their underpinning rationales. On the basis of which, we can consider whether the present way and extent of redistribution complies with what the *rationale* prescribes.

The full case for European redistribution

But Ambition's argument is not merely immanent, but it is also grounded on critical normative reasons. Her argument goes that even if we were not redistributing, we should redistribute across borders. And this is so for two main reasons.

On the one hand, European integration has undergone a *qualitative transformation* through the years. From the *Little Europe* circumscribed to a limited set of economic issues we have gone through several transformations leading to a mature political community whose laws affect all European citizens quite directly. To the extent that we accept the definition of «political community» as a «union of multitude of human beings under laws of rights»,²⁷ the European Union is already a political community. This entails that it is a new level of *politics*, a new level of government. Part of its legitimacy derives from its scope, from its *prima facie* legitimacy to deal with issues which have a basically supranational kind of audience. But a full legitimacy credit can only be based on the usual sources: participation of citizens in the making of the laws, guaranteed substantive outcomes through rights protection and foreseeing procedural rights to control the process of implementation of the law.²⁸ Given the *programmatic* definition of the Union as a polity based on the four basic freedoms, the case for including mechanisms of redistribution within Union law becomes very strong.²⁹

²⁷ Immanuel Kant, 'Practical Philosophy', (Cambridge University Press, Cambridge, 1999), p. 455. The quote is from the section on Public Right of the *Metaphysics of Morals*. He was defining the state, but we should do better to reinterpret this as political community, to avoid the immediate association of state with nation-state. For an argument on why the European Union is a state in a Kantian sense, see Ferry, *La Question de l'état européen*,. (Paris, Gallimard, 2000).

²⁸ This triad is further developed in my *Justifying Taxes*, (Dordrecht, Kluwer, 2001), chapter 6.

²⁹ Even if *legitimation through the protection of substantive rights* complements but cannot substitute *legitimation through participation in the making of the laws*, it can be said that the emphasis on rights protection should be stronger the less room there is for direct citizen participation in the

On the other hand, the bracketing of socio-economic questions from the *constitutional structure of a political community* is acceptable only to the extent that there are other means available to ensure the actual fairness of the basic economic structure of that society. Redistribution is the actual means to achieve such end. Communitarians and neo-liberals argue that a basic degree of economic justice can be ensured through an ethical or self-interested commitment of the electorate to redistribution. However, this presupposes a type of social stratification and cohesion that is not characteristic of the European Union (and, contrary to romantic views, hardly any longer of any nation-state).³⁰ Solidarity among strangers should, in my view, be the background model of democratic distributive justice. In that context, basic rights to solidarity, as the right to a basic income, the right to education, to housing or health care are part and parcel of the basic rights that citizens should mutually recognise each other. The «emptying» of politics can be avoided by *proceduralising* as much as possible those basic social rights. This recommends moving away from the *paternalistically tainted* provision in kind³¹ to more autonomy-respectful forms of redistribution, such as income transfers.³²

Prudential Reasons: Redistribution as the price of European civilisation

Ambition is ready to present additional reasons to the *normative* case which has just been made. Her prudential case for redistribution at the European level is based on the argument that redistribution is to be regarded as the price of European civilisation.

The boastful rethorics of competition lawyers is the *acquis communautaire*. The four economic freedoms are said to have been the major *glue* holding together European integration and neutralising centrifugal forces. Ambition is inclined to consider a different language when asked to provide prudential reasons for redistribution. She has sufficient evidence to claim that for most Europeans the *true acquis communautaire* is the success in establishing developed welfare states across Europe. For a while, the process of European integration, even as a purely market-making exercise, and the process of entrenching the welfare state seemed to mutually

making of laws. That is not an argument for *bread and circus*, but for redressing the *legitimacy deficit* as much as possible within the existing structures.

³⁰ On the conundrum of *liberal nationalists* approach to distributive justice, see Robert Goodin, 'Justice in One Jurisdiction, no more!', forthcoming in *Philosophical Topics*, 2002.

³¹ But see Frank Michelman, 'On Protecting the Poor Through the Fourteenth Amendment, 83 *Harvard Law Review* (1969), pp. 7759.

³² I am not claiming that the right to basic income, for example, is an all-purpose cure. In my mind, it is more promising to have a several layer mechanism of redistribution. For a more articulated policy proposal, see Bruce Ackerman and Anne Alstott, *The Stakeholder Society*, (New Haven and London, Yale University Press, 1999).

reinforce each other. But tensions became evident from the late 1970s. The weakness of social Europe is the result of a lack of sufficient and direct concern with social standards at the European level, but it is also the result of a lack of positive programs that try to redress inequalities and social problems at a European level. The lack of willingness to transfer national competencies on social policy and the insufficiency of revenue collected through taxes at the European level are to blame.

The time has come to neutralise the centripetal force of such tensions by means of ensuring social standards and provisions at the European level. Redistribution can be regarded as the *price of European civilisation*.

Practical Aspects and the cunning of reason

Normative arguments tend to be accused of naivité. However, nothing prevents normative arguments from being cunning. At the end of the day, the best argument is not one that fits perfectly into an ideal system of justice, but the one that passes the double test of normative correctness *and* effectiveness.

Two of the main obstacles towards the development of an autonomous power to tax on the side of European institutions are the following.

First, Europeans do not perceive clearly the *European* character of the own resources of the Union. The problem can be illustrated by considering the different perception of on the one hand agricultural levies and duties and customs duties and on the other hand the Value Added Tax.

As has been argued, the first step towards the establishment of a system of own resources of the Union was taken in the Hague Summit of 1969. The goal of establishment a Customs Union had been achieved the year before, ahead of schedule. Customs duties, next to agricultural levies and duties, were transferred from member states to the Union. The transfer will be progressive, starting from 1971. But most of the revenue, as we have seen, was expected to come from the Value Added Tax. A set of directives had established the normative foundations of sales taxation within the Communities, to be implemented nationally. The direct goal was to eliminate distortions to trade that could endanger the achievement of the goal of setting up a common market among the member states. After a long discussion, Member States agreed in 1979 on the criteria to be used in order to calculate how much of the total amount yielded by the Value Added Tax should be transferred to the Union.

Social perceptions on customs duties adapted very quickly to the transfer of the tax from Member States to the Communities. Given the existence of the Customs Union, the rationale for transferring the revenue yielded by customs duties to the Union is that there are no longer tariff reasons to export directly to each national

European market. Exporters and importers can make full use of the economic advantage of certain locations as entry points of extra-European goods into the Communities. This is what has actually happened. To refer only one example, the port of Rotterdam is a major port of entry of goods aimed at being sold in all member states. Given the potential dramatic increase in traffic and therefore in customs collected, and given that that is the result of the Customs Union, it seems fair that the revenue reverts to the Union and is not kept by the Netherlands. This argument seems to have worked so well that almost nobody challenges that customs duties and agricultural levies are European resources properly speaking.

The reason for making a percentage of the VAT collected in member states an own resource of the Communities was not so different. The tax base of VAT is sales. The creation of a common market was said to have not only increased the frequency of cross-border economic transactions, but also to have led to a growth of the economy as such, which would lead to a higher level of spending. The Value Added Tax, as all sale taxes, is based on the argument that the economic transaction reveals or betrays the *economic ability* of the purchaser of the good or service³³. Part of such economic ability should be traced back to the common market, which was advocated in the name of the increased standard of living that it will ensure Europeans, by means of ensuring peace (and hence basic security and stability) and by means of promoting or increasing economic growth or prosperity. However, this is not how things are perceived. The fact that VAT legislation is heavily framed by European directives is obscured by the sheer fact that the tax is collected by the member states, and as such, it has not become fully internalised that the tax is as European as customs duties. Thus, the threat made by Germany, France and Luxembourg of not transferring the third resource, the percentage of VAT, when a considerable row erupted over the composition of the budget.

Second, the move away from VAT as the main resource of the Union was made on the argument that paying for Europe through VAT was unfair in distributive terms. This is an appealing argument, as it is well known that *sales taxes*, such as VAT is, tend to be regressive in distributive terms, that is, the well-off pay a lower percentage of their income in sales taxes than the worse off as they have a lower propensity to consume their income. However, the argument was combined with a

³³ This can be clearly seen by considering the rationales of the reduced or zero rates of VAT applied in the different member states. A recurrent argument is that the *basic* nature of the good or service implies that even those with a very limited ability to pay could not avoid incurring in the expense associated to the good or service in question. To use a clear example, the acquisition of basic food products is subject to a 0 rate in some countries, such as the United Kingdom. Because even the less well-off members of a society need to buy such basic products, buying such products does not necessarily reveal or betray an ability to pay.

less evident claim, namely, that the member states, not individuals, should be the unit of contribution to finance the cost of Europe. If the only problem was the interpersonal regressiveness of VAT, it would be possible to fix it by means of moving away from sales to personal taxes as the own resource of the Communities. The undermining of Union's financial autonomy was rendered possible by collapsing into a single argument two very different arguments.

The lessons to be derived are also two. The taxes to be transferred directly to the European Union should have two basic qualities. First, they should be easy to associate with the *benefits* or the *problemsolving* capacity of the European Union (this would render intuitive why the tax is collected at the European level). Second, they should be clearly progressive, in the sense of imposing a higher economic burden of those who are better off economically. European taxes should be those which clearly operationalise the idea that is fairer that those better off pay a higher share of their taxes than the lower off (in that sense creates a positive association with the idea of the individual, not the member state, as the unit of distributive justice).

The ideal would be, then, a tax which associates the two; a tax which operates according to the benefit and the ability to pay principle; a tax that falls especially on those who are doing well thanks to the common market, on those who have gained most out of the existence of the Union, or at the least, more evidently.

This leaves us with several candidates which rank high in both normative and prudential terms. Two of them are a tax on savings income and a European personal income surtax.

As it has already been hinted, the income derived from savings has become de facto untaxed if the income is obtained in a jurisdiction other than that of residence of the taxpayer. This is the result of a series of legal, economic and technological changes, among which the globalisation of financial markets and the *deep* deregulation of the movements of capitals within the Union. The member states have committed themselves to introduce the buffering mechanisms that would allow member states to regain the factual capacity to tax savings income. This would be rendered possible by the exchange of tax data among European tax administrations.

Modesty and Ambition could argue that member states should not tax savings income, but transfer the power to tax to the Union. Such a tax would rank high both in normative and prudential terms. On the one hand, it would be easy to argue why it should be transferred to the Union. As things stand now, most of such income accrues to people who are actually making use of the free movement of capital. Moreover, financial institutions operate in a European normative framework. The *benefit* principle would make it clear that the tax should be allocated to the Union, not to member states. Moreover, in the short run it would be very obvious that if

such income can be taxed, it is thanks to the problem-solving capacity of the Union. Only by coordinating their efforts at the European level can member states regain capacity to actually tax such tax base. On what concerns the ability to pay principle, it is well established that the better off one person is, the higher the percentage of income it derives from capital. A tax falling upon savings income, even if applied at a proportional rate, would be burdening the better off. Moreover, those better off would be those who are making full use of the possibilities provided by the economic freedoms, in this case the free movement of capital.

It might be added that such a tax would put a premium on national inequality. There is clear evidence that *the richest* are the ones whose income derives in a higher percentage from capital. If capital income becomes a proper basis for taxation of the Union, then the richest will pay more. This would put a premium on countries allowing higher degrees of inequality, as the further inequality goes, the higher the percentage of income obtained through savings.

Turning to a European personal income surtax. It could be established as an additional tax to be paid by those who are obtaining income in more than one member state. Such criterion would render it clear why the European Union should be receiving the proceedings of the said tax. Its *raison d'être* would be that those who are able to obtain their income in different member states are making use of one or several of the four economic freedoms, and as such, are clearly beneficiaries of the existence of the common market. So the tax would comply with the benefit principle as a criterion to allocate the competence to tax. Moreover, the surtax could be collected at a progressive rate, as personal income taxes are in member states. This would ensure that it ranks high in terms of distributive fairness.

From Europe to the world

By now, the reader has been presented with Modesty's and Ambition's cases for granting a genuine (autonomous) power to tax to the European Union. The arguments that have been made are both normative and prudential, and claim to be mutually self-reinforcing. On the one hand, the basic principle of public finance, no expenditure without taxation, aims at guaranteeing a *political vigilance* and *control* over public institutions. On the other hand, the thickening of the common interests and needs of Europeans is said to constitute a justification for the introduction of redistributive, market-compensating measures at the European level. Finally, it was argued that such arrangements would ease the endemic conflictual nature of the present system of financing the Union. By rendering clear that the main unit of contribution and redistribution should be the individual citizen, Ambition and Modesty offer a different map of the interests at stake.

The arguments of Modesty and Ambition have quite concrete implications for the institutional design of the European Union. But this paper claims (as it is obvious in its title) to indicate how we can move «Towards cosmopolitan redistribution». My main claim in that respect is that implementing Ambition's strategy (and even, but to a lesser extent, Prudence's) would constitute a major step towards redistribution at a global level. In this section, I try to spell out in detail the connection between *redistribution within the European Union* (mainly, but not exclusively, associated with the second strategy) and *redistribution at a cosmopolitan level*. This is done around three main arguments, namely, (1) that the legitimacy credit of the European Union is partially dependent on the building of a cosmopolitan order; (2) that European redistribution implies conceiving of redistribution as a matter of solidarity among strangers, an apt model to conceive how redistribution should operate at the global level; (3) that the actual implementation of European redistribution leads to the testing and experimentation of policy measures to render such redistribution effective, including measures to buffer existing national and regional schemes of redistribution.

The European Union can only be fully legitimate if it aims openly at the building of a cosmopolitan order

What the European Union is for seems to be the *most* contested issue on European integration. In general terms, the question is open to a bewildering multitude of possible answers. However, this apparently intractable problem can be rendered more tractable by leaving aside the question of ultimate ends and starting by analysing the conditions of legitimacy of public institutions.

We can affirm that whatever the purpose of a public institution, it can only be justified and accepted if it complies with the criteria of legitimacy. The basic of such criteria is that all those affected by a common action norm (typically a legal norm in modern societies) should have a say in the deliberation and decision-making previous to the fixation of such norm. Such criterion leads to three main sets of legitimacy standards, covering the process of making of common actions norms, the substantive qualities of such norms and the guarantees concerning their actual implementation³⁴.

In such a light, the Union must be seen as a new level of politics, that emerges as a result of the thickening of the common interests shared by the nationals of the different European states and regions. Due to a series of political, economic and technological factors, it cannot keep on being assumed that the action of individual citizens or the public institutions that act in their name will affect only those same

³⁴ See Agustín Menéndez, *Complex Democracy and the obligation to obey the law*, Working paper 20/2000, ARENA, University of Oslo.

citizens. Two devastating wars were needed to realise the assumption that for many purposes, Europeans are in the same boat, in less graphic terms, they have a considerable number of common interests that can only be regulated legitimately and efficiently by doing it together. Sharing common interests determines the *scope question* of democracy, namely, the level of politics at which issues should be dealt with. It serves to allocate competencies, which should then be exercised in accordance with the three-folded set of criteria of legitimacy (procedure, substance and guaranteed implementation).

Ambition, and Modesty to a certain extent, have argued for trusting the European level of politics with the task of redistributing economic resources across borders to ensure the achievement of a certain degree of equality among Europeans.

The building of Europe ends up with the myth of the self-sufficient nation-state. By doing so, it renders difficult, both in practical and normative terms, to pretend that politics should stop with this new level of government. Even if it is clear that the commonality of interests becomes thinner once one goes beyond the European borders, there is a commonality that demands something else that just accepting a sort of state of nature.

If this is so, the case of Modesty and Ambition to redistribute within Europe should lead to arguing the case for redistributing beyond European borders. Such a case might be weaker, demanding a lower level of commitment towards equality, but it would still be a case for global redistribution.

In short, Europe cannot redeem its full legitimacy credit unless it affirms the need of establishing a further, global level of politics, which includes redistribution across borders as its task.

Redistribution at the European level shows that the adequate way of thinking about redistribution and modelling it is solidarity among strangers, not ethical criteria

Arguing for redistribution at the European level presupposes a model of how *solidarity among strangers* is to be justified, and of its implications, that is *what it requires and calls for*. This element of transcendence of the nation-state constitutes a building block for a model of *cosmopolitan redistribution*.

As Ambition made clear, the case for redistribution at the European level builds upon the actual practice of nation-states. No matter which are the social perceptions about the European welfare state, its actual practice is based on the *resident*, not the citizen, as the unit of contribution and redistribution. Ambition also made it clear how the process of market-making renders necessary the adoption of explicit measures aimed at redressing the normatively unacceptable consequences of its motion.

It helps thinking about the criteria that should be used in order to interlock the different measures of redistribution

The first lesson that can be derived from a model of European redistribution is the need to establish criteria of allocation of the competence to redistribute. In that concrete respect, one can find the use of the *benefit principle*. The benefit principle would guide the allocation of taxes to one or the other jurisdiction. Whether corporate taxes should be paid to the Union or the member states, or on which percentage they should share the revenue yielded by this tax is something that the benefit principle can help to determine. Consider the following line of reasoning. In most member states, corporate taxes accrue to the nation-state. The usual argument made for justifying such outcome used to be complex, and had to do with normative and prudential reasons. Among the former, it was usual to refer to the fact that companies operated on the basis of norms that are shared by all the residents within the said member state. Even if a company operated locally, the production or delivery of goods and services was underpinned by a *national* legal system and rendered feasible by the existence of a common national market and a nationally regulated system of finance. Among the prudential ones, one could refer to the risks of unleashing a race to the bottom among different regions if they gain the capacity to legislate the rates of the corporate tax. After the full implementation of the Customs Union and the common market, the community of sharing which underpins the set of norms applicable to companies has shifted from the nation-state to the Union. This constitutes a *prima facie* argument for shifting the level at which the tax is collected and spent³⁵ If, to just an example, companies constituted in the Netherlands do well in the European market, they do so by making use of the possibilities opened up by the existence of a common market. Why should the resulting taxes accrue only to the Dutch government, and therefore go into the provision of public goods and services to Dutch residents? To justify such outcome, it would not suffice to claim that this has been the practice. Countervailing reasons should be shown.

The second lesson concerns the specific or detailed mechanisms which are necessary for ensuring the viability of redistributive measures at the European level are also needed for ensuring the viability of such measures at a global level. The European level might be made to act as a buffer, protecting national welfare systems against the pressures coming from global deregulation. Thus, as things stand savings income is virtually non taxed if it is generated in a country other than that of residence of the saver. The forthcoming directive on the taxation of savings income would create a buffer against such kind of pressure by means of establishing the the

³⁵ There might be other countervailing reasons that could render advisable to split the tax between the Union and member states.

principle of exchange of relevant tax data between tax administrations. This is required to ensure the fairness of regional, national and European taxes, but it constitutes at the same time a building block of an international fair order.

The third lesson is that the effective establishment of a panEuropean system of redistribution will reinforce the case and the feasibility of redistribution at the global level. This hypothesis can be confirmed by the fact that, among global powers, the European Union is the only polity where civil society has been successful in promoting concern about such kind of issues, something reflected in the intimate link between fundamental rights and external policy, and also on the increased permeation of commercial policy by such standards.

A system of redistribution of economic resources within the European Union must be seen as a first step towards cosmopolitan distributive justice. There are very good arguments to aim at redistributing resources at the global level. If borders do not matter any more for the purpose of moving goods, services and capital³⁶, they should not matter when it is time to redress the legitimacy deficit of market arrangements. *Justice in One Jurisdiction, no more* is an apt normative motto. However, intermediate steps are necessary to avoid the feasibility criticisms. Entrenching mechanisms of redistributive justice in the European Union would force us to confront the same questions as aiming at redistributive justice globally. But the European Union is already a political community. No matter how insufficient its democratic credentials, they are far superior than those of the International Monetary Fund, the World Bank, the World Trade Organisation and even the United Nations. This explains why it is in the process of buffering national welfare systems against the pressures of global deregulation.

European redistribution can be said to constitute a golden bridge towards global redistribution.

³⁶ Although it is usually assumed that there is some kind of similarity between the *globalised economy* of the beginning of the XXth century and that of the beginning of the present century, such similarity is not normatively relevant. The global economy of the 1900s was articulated around *trade* between national units and *flows of foreign capital* that then produced goods within the country of destiny. The global economy of the 2000s is characterised by the actual integration of the production and financing of economic activity across the globe. One should not romanticise either the *liberal* policy of free movement of workers in the 1900s. It is true that the passport control system, to which modern immigration policies are so closely anchored, emerged after the First World War. But it is also true that the absence of controls was matched by the almost conspicuous absence of the welfare state as we know it. One has to read together, so to say, *The Death Ship* of B. Traven and *The Jungle* of Upton Sinclair.

Alexander Cappelen:

Comments

First of all, I really enjoyed reading the paper— and my own thinking on these issues has greatly benefited from your paper. However, I still have some problems with the conceptual analysis, in particular the distinction you make between taxes and contributions, and the distinction between different units of contribution or distribution, and with the content of the two proposals. I'll explain briefly explain why.

- i. First, it is not obvious what the economic or moral difference between national contributions and European taxes really consist in. Ultimately also the national contributions are paid by taxpayers.
- ii. States can never be the ultimate unit of contribution – individuals always are. Thus the distinction between the individual and the nation-state as the unit of contribution is confusing.
- iii. Furthermore, we can always replicate any system of taxation with a system of national contributions, by letting national variables enter into the calculation of the tax burdens. The difference thus seems to be political and psychological rather than economic or moral.
- iv. The important point must be how we calculate the individuals' contributions. Should nationality be a variable that is taken into account when we calculate what an individual should contribute?
- v. Your answer seems to be NO. Nationality is – according to Modesty — not a morally relevant factor when we calculate individual contribution.
- vi. A similar point concerns your distinction between the unit of distribution: you ask whether the unit of distribution should be the individual or the nation-states. But, essentially it is always the individual who is the unit of distribution. Transfers to a nation are meaningless unless they in the end are transferred to individuals within that country.
- vii. The important question is whether nationality should be a morally relevant factor when we consider how to distribute income between individuals in Europe.
- viii. Your answer seems again to be: NO. And the main argument – put forth by Ambition — seems to be some version of a mutual benefit theory — theories hold that our distributive obligations arise from economic cooperation and the thickening of such relationships will therefore reduce

the importance of national borders for distributive justice. (You also suggest other arguments).

My position

- i. I agree with the main normative position in your paper: that we have the same distributive obligations towards all Europeans independent of their nationality. The moral equality of Europeans can be justified in many different ways – how is not important to my argument.
- ii. I do not, however, agree with your conclusion that we should try to equalize income at the individual level across Europe.
- iii. My position is that there should be an asymmetry between redistribution at the national and the supranational level. Furthermore: we should accept inequalities across Europe that we would not accept within each nation-state.
- iv. This argument is not based on differences in moral obligations, it is based on the simple idea that society should eliminate inequalities resulting from factors outside the individuals' control, but should be held responsible for inequalities that are a result of factors under their control.
- v. This idea is, as you will recognize, the essence of modern theories of equal opportunity or liberal egalitarianism (or factor selective egalitarianism as I would have preferred to call it).
- vi. My argument follows from the fact that things that are outside the control of an individual as an individual might be under her control as part of jurisdiction such as a nation state. We should therefore hold the individuals accountable for things internationally that we should indemnify them for nationally.
- vii. An example, from the educational system, might be illustrative. Nationally we should hold students responsible for their effort in the educational system. However, we should not hold them responsible for the structure of the education or the resources used. However, internationally we should not compensate for such differences since we want to hold the members of a democracy accountable for their decisions. If we compensate for differences in the educational system that are due to differences in national policy we would undermine the whole idea of national autonomy.
- viii. As a result: we should redistribute between countries so as to compensate for differences between them that are NOT a result of national policies, but we should accept inequalities that are due to differences in national policies. This means that it IS justifiable to use nationality as factor in calculating

both taxes and transfers. And given that it is justifiable to do this it would be perfectly legitimate, even more transparent, to use national contributions rather than taxes levied at the European level. And it would NOT be justifiable to attempt to eliminate all inequalities between Europeans at the individual level.

- ix. You say that European taxation is the price we have to pay for a European Civilization. I would say that national contributions are the price we have to pay for national autonomy!

Comments

First I would like to thank Menendez for presenting a very interesting and well-argued paper on the case for a European power to tax and why this development should be seen as a first step towards cosmopolitan redistribution.

In my commentary I will first depart from Menendez subscription to the view of no taxation without deliberation, meaning that all those affected by a common action norm should have a say in the decision process of such norms. My first comment concerns what I will call the missing voices of reform in your presentation

1. *Missing voices*: In the presentation of reformers you present two Cases, «Modesty» and «Ambition». They share a basic positive view of the EU and they see it as desirable to have a society in which market forces are balanced through redistributive measures implemented by the political community. By framing the reform options in this way including only different versions of those favouring a change towards a European power to tax, there is no taking into account the role of «the bad guys», i.e. those who on different normative grounds oppose the EU as such or oppose any increase of taxing and spending power to that level of governance. These voices range from those who favour redistribution and equality but see the combination of market forces and distant bureaucracy as undermining such goals, to those who reject redistributive intervention into what they see as fair outcomes of the market. In the «normative universe» set up by Menendez there is thus a lack of recognition of normative considerations that see reforms in the opposite direction as desirable. Thus, taking seriously the democratic or deliberation aspect of a European tax reform will not that require an inclusion and consideration of these missing voices in your discussion?
2. This brings me to a closely related topic concerning the *social and political bases of European and cosmopolitan redistribution*. In the paper you present the normative and prudent arguments in favour European and cosmopolitan redistribution. In order to be institutionalised such norms are in need of social and political forces supporting them and struggling to install them against opposing forces through the democratic process. There is little discussion about who these social and political forces may be and whether they are strong enough to counter the opposing forces. It would

have been interesting if you could give us your view on this. In your paper you hint at one social development which you call «the thickening of the common interest and needs for Europeans» which would make the case for an institutionalisation of European taxation more viable. Although I agree with you in seeing a thickening of common interest, there is also a potentially contradictory trend towards a «shrinking» or narrowing of common interests and needs, a process in which increased prominence is given to individual freedom and choice and less to collective solidarity. Signs of such developments are seen both as regards reforms of national tax systems as well as in social security institutions. More trust and responsibility is given to the individual in coping with different risks and correspondingly less responsibility for the public sector. This said to stress the openness of the situation regarding how different people evaluate it to be one of «thickening of interests» or the opposite.

3. My third point concerns the importance of *connecting the basic content of national tax reform of the 1980s and 1990s to the ideas of cosmopolitan redistribution*. This reveals a possible contradiction between the ideas of European and global redistribution and the reality of tax reforms. Central elements in those tax reforms were base broadening, reduction of tax rates and change of taxation towards more indirect taxes. (This is by the way very close to the EU recommendation cited on page 19 in your paper). The frustration with progressive income taxes was motivated by several factors, for instance the combination of formally high progressive rates combined with an extensive system of deductions and exclusions undermining the trust in the income tax institution. There were and still are discussions on the possible negative incentive effects of high tax rates on labour market participation and economic growth. Some argue that it is unfair that those who contribute the most (the better of) should be punished by higher taxes and that as the national economy grows people ought to keep a higher proportion of their income at their own disposal. The point is that the national discourses and reforms on taxation seem to move away from redistributive taxes on labour income towards more taxation of consumption. In short the ability to pay principle in taxation may be weakened at the national level. In my view this creates an important obstacle for the idea of European and global redistributive taxation. If it is correct that those better off are increasingly unwilling to share the burdens according to the ability to pay principle of taxation within nation states,

then I would like to ask why should they change their view regarding an European system of taxation? Or put it differently: Why should successful people see their success as a result of the four freedoms and not rather as a result of their own individual effort as they usually will claim?

Finally, *different historical experiences* as regards legitimacy of the state and construction of different types of welfare state are to be found within Europe. These welfare states including the structure of tax systems vary in their degree to which income redistribution is seen as a goal. Within a system of European taxation what kind or direction of harmonisation regarding this redistributive goal do you see as preferable and what are the implications in terms of total tax level of Europe (adding together EU and national tax levels) should it increase, stay the same or be lower than today? (The answer on this question is of course relevant for the discussion on globalisation and competitiveness).

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