A ROADMAP FOR AN EU BUDGET IN UNCHARTED TERRITORY?

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Dear Tax Colleagues,

Dear fellow Europeans,

The Corona pandemic: an invitation to wider reflection:

This year's annual meeting of the EATLP takes place in a very special format. Instead of assembling and mingling during two days with a few hundred colleagues, we are sitting hundreds of miles apart and watching each other for thirty minutes on a mini-screen. After three months of lockdown, this special time of social distancing is an excellent opportunity for a reflection that is wider than the technical tax subjects which we are usually discussing.

Taxation is an instrument, not a goal in itself:

As tax academics we should be aware that taxation is merely an instrument to achieve wider political, economic and social objectives in our society at large. Taxation only deals with the ways of collecting public money. The other side of the coin is the spending side. We can only fulfil entirely our role as academics in society, when our study of taxation is fully embedded in the objectives of public policy pursued by spending taxes. In the end our tax techniques make only sense through the non-tax achievements in business, culture, sports and social services.

The impact of the Corona pandemic:

The Corona pandemic has focused our attention to one single issue that worldwide has become centre stage: how to end the threat of the Corona-virus to public health and how to overcome the economic and social consequences. But even when we would overcome its Corona crisis, there remain two other long term threats that

temporarily have been obfuscated by Covid 19 to wit the climate crisis and the Immigration crisis.

Two generations ago, after World War II, the overriding challenge in Europe was how to prevent another war between the two major continental powers France and Germany. The foundation of the European Union was the answer to this overriding challenge. That Union has been a resounding success in preserving peace among the historic enemies of Europe.

Today there is no immediate threat of war. If there is any danger of a full scale war it comes from outside the European Union. The lives of our children and grandchildren in all the member states of the Union, will rather be determined by the outcome of the three new challenges: Covid 19, climate and immigration.

Meeting the first challenge of Covid 19 will be first and foremost a task not of the Union, but of the member states. The competence of the Union in health care is very limited indeed.

Countering the negative economic consequences of three months of lockdown and the ensuing 90 % economy consists mainly in separate national efforts undertaken by the member states. The health impact of the pandemic has been very unequal: from 57,43 deaths per 100,000 inhabitants in Spain to 33,09 deaths per 100,000 inhabitants in Ireland, by the end of May 2020. The economic damage caused by the pandemic varies accordingly. Therefore individual member states are best placed to decide which measures to take to turn the economic tide. It is for the member states to elaborate the concrete plans and projects adapting and strengthening their economic structure in order to overcome the crisis.

The difference of EU financing:

There is one area however where the EU will make the decisive difference between failure and success and that is the area of

financing the recovery initiatives undertaken by the member states. There is a consensus among economist that the financial means for the recovery programmes should not come from current fiscal revenues from the member states, but should be borrowed in the financial markets and repaid in the long term by the increased in economic growth resulting from the recovery programmes. There is also consensus that the combined borrowing capacity of the EU is substantially higher than the separate borrowing capacity of the separate member states and the interest charged to the EU is lower than the interest charged to individual member states. Therefore the conclusion is clear: the financial means for the programmes of economic recovery that will be executed by the member states shall be financed by EU borrowing.

Two important aspects are linked to this EU financing. There is a quantitative aspect of the amounts to be borrowed and to be spend and there is a qualitative question of the nature of the funding by the EU, either as repayable loans or as subsidies "à fonds perdu".

The quantitative aspect has to do with the budgetary control of the spending of the programmes for economic recovery. In the aftermath of the financial crisis the Union has subjected all member states to a system of European semester monitoring within the treaty framework of multilateral budgetary surveillance. The purpose of this monitoring is to enforce budgetary discipline to all EU member states in order to limit annual budget deficits and the total amount of outstanding public debt. There is widely shared consensus among economists that for the duration of the crisis, it is not a good idea to enforce the budgetary discipline envisaged by the Stability and Growth pact. Now is the time to relax the budgetary criteria. Such a relaxation of budgetary restrictions makes a world of difference for national authorities in designing their projects for economic recovery.

The second aspect relates to the repayment of the expenses for the economic recovery. During the financial crisis in Greece and other

member states financial assistance to states in distress took the form of loans. The objective was to prevent state bankruptcy by enabling those member states to meet the financial deadlines for the repayment of their public debt. The iron rule was that the loan was subject to conditions of economic reform, that interest was due and that in the end the full amount of capital had to be repaid by the borrowing member state. The effect of these new loans was to increase the public debt of the member state in question, which made it more difficult to conform to the budgetary restrictions imposed by multilateral budgetary surveillance.

If financial assistance by the EU could change in nature from a loan repayable by the member state receiving the aid to a non-repayable subsidy such a change would clearly make a world of difference, because the total amount of aid received would no longer burden the national budget.

These two fundamental changes, the quantitative change as well as the qualitative change are incorporated in the proposals for the multiannual framework 2021-2027 and the EU Next Generation Fund that have been submitted on May 27 by the Commission's president Ursula von der Leyen and that will be discussed at the EU summit the very moment that I speak to you. These are bold proposals because they are real game changers both in the size of the ambitions of the EU and in the way the EU seeks to finance these ambitions. These changes are fully justified, because of the change in the nature of the challenges.

A difference in challenges justify a change in financing:

The economic challenge resulting from the health crisis is not an economic accident like the financial crisis was, caused by errors of economic judgement or irresponsible economic behaviour. The remedy for that crisis was reinforcing supervision and reinforcing the

financial buffers of banks and as soon as possible otherwise going back to business as usual.

To meet the challenges of the economic recovery from Covid 19, and the challenges of the climate and the immigration crises the answer is not back to business as usual. Not only the European Union, but the whole world will have to rethink the organisation of the economy: the way we produce goods and services, the way we trade in goods and services and the way we consume goods and services. Today the internal market and the economic union itself are in danger by the human and economic damage of the Covid 19.

Climate change:

In the EU very few people need to be convinced of the width and depth of climate change. Increasingly climate change is not seen as an insurmountable challenge, but rather as an opportunity to develop the EU into a circular economy in which a high standard of living is totally compatible with durability and sustainability. Gradually the European Green Deal is shaping up. It is a staggering enterprise which exceeds the capacity of the individual member states. It can only be successful when the EU takes the lead setting out the general lines and targets and providing substantial financing.

Immigration:

How the EU will meet the challenge of immigration is still shrouded in uncertainty. Many Europeans still consider the protection and reinforcement of the outer borders of the Union as the main issue. However the long term issue is not so much border protection, but rather peace and human and economic development in Africa and the Middle East. Because of the population explosion in sub-Saharan Africa pressure from immigration on Europe will increase in the future. The African Development bank predicts an increase of 450 million people in sub-Saharan Africa between 2015 and 2035. Even if only one tenth of this increase in population would migrate to

Europe, that would mean an immigration of 2.25 million a year during a period of 20 years. This does not take into account migration from Middle East countries like Syria, Iraq or Afghanistan. Such a massive flow requires other measures than tighter border controls or equal dispersion of immigrants over all 27 member states.

No doubt the population explosion in Africa constitutes a terrible challenge, but it can also be seen as a potential opportunity. Africa is the continent on earth with the highest potential for economic growth. It is the continent with the highest potential for raising the standard of living of a population that is bigger than that of China. It is the continent with the highest potential of lifting hundreds of millions of people out of poverty. The only solution to this challenge is solid and stable economic growth. Just one generation ago Europe was flooded by Chinese students who desperately wanted to stay here. Today they return to their homeland because it offers them more opportunities than Europe. Why does the EU not initiate a European Belt & Road programme for Africa, or an African Next Generation Fund, tying its future in a positive way to the future of this continent? Only by helping Africa grow, will Europe help itself in resolving the immigration problem for Europeans and Africans alike.

Vision also needs cash:

Turning the threats into opportunities requires vision, but also requires cash. The vision of this staggering enterprise also needs a staggering amount of cash. That staggering amount of cash cannot be financed out of current fiscal revenue, neither by the member states nor by the EU. Therefore it is the right decision to borrow the cash necessary to meet these three challenges. Collective borrowing by the EU is cheaper than separate and individual borrowing by the member states. Since the EU is proposing to subsidise member states in order to meet these life and death challenges it also means that the obligation to repay the loans collectively falls on the EU and not on the individual member states.

At present the budget of the EU is totally inadequate to repay that staggering amount of cash, which the Commission is planning to borrow . The 2020 budget of the EU amounted to €168 billion. That amount represents approximately 1 percent of total EU GDP, and about 2 percent of all public spending through the national budgets of the member states. That is peanuts compared to the national budgets of the member states. All member states together are currently spending 50 times more public money than the EU commission. To expect that with a budget of these minimal proportions the EU will have a measurable impact on the three major challenges of Covid 19, climate change and immigration is expecting that the EU tail will be wagging the national dog.

The question is how to pay for this. Currently the lion's share of the EU budget comes directly from member state contributions, 65.9 % from direct contributions by the member states based on gross national income (GNI) and 11,1% from VAT collected from the common tax base. Member states consider these contributions as a direct burden on their national budgets. It is unthinkable that in post-corona times member states will increase their national taxes to finance to repay the loans contracted by the EU. The correct answer to this riddle is that when the repayment of these loans is an obligation for the EU budget the repayment of these loans should be financed by EU taxes. These EU taxes could then gradually replace the direct contributions through the national budgets of the member states. It is only a principle of orderly public finance that the level of government that is competent to implement a public policy is also responsible to raise the revenue necessary for the implementation of that policy.

How will the EU raise the cash to repay the loans?

In cauda venenum. The poison is in the tail. There is one last and difficult question in which the vision to overcome the three challenges of the EU is confronted with the necessity of taxation.

How is the EU going the raise this amount of cash? The standard answer at any level of government is that spending is financed by raising taxes. The problem of the EU is that, except for customs duties, the EU has no power to raise EU taxes. It only has the power to harmonise national taxes when this is necessary for the establishment and the functioning of the internal market. The amount of custom duties raised by the EU represents only 12.8 % of the current annual budget of the EU.

Yet there are many people and many businesses that earn good money and make big profits thanks to the existence and the functioning of the internal market. Digital services, financial services in the euro-zone and above all multinational economic activity inside and outside the EU flourish thanks to the existence of a wide and deep internal market with common rules and common standards administered by the EU. All these benefits are delivered at the price of an EU budget of 1% of total EU GDP. According to the benefit principle, which is a fundamental principle of taxation, it is legitimate to request a tax payable to the budget of the EU, from all these economic agents who benefit from the existence and the facilities of the internal market. Is not one of the new prevailing theories in international taxation that the sole access to a large market justifies a tax contribution to the government organising and facilitating such a market?

Such a direct tax payable to the EU budget would also resolve the persistent problem of how to allocate the revenue between the national budgets of the member states of a harmonised tax base. That problem has been blocking for a decade any progress on the proposal for a Common Consolidated Corporate Tax Base. The simple solution is to allocate this revenue directly to the EU budget, which dispenses with the problem of allocation to the member states. Taxes that are directly related to EU wide activities closely linked to the internal market and the economic union should flow to the EU

budget. The best way to completely eliminate tax distortions of competition is to apply these taxes to a common and uniform tax base subject to one single tax rate that is identical in the whole EU. If all the revenue of these taxes flows to one single EU budget there is no need to allocate these taxes to national budgets.

Raising EU taxes requires an amendment of the European Treaties:

Authorising the EU to raise these taxes for its own budget requires an amendment of the European treaties. That solution is currently dismissed by nearly all European political leaders as a “mission impossible”. The main argument against authorising such direct taxing power for specific taxes to the EU, is the threat to national fiscal sovereignty. That argument was rational in 1957, more than sixty years ago, when the immediate and fundamental purpose of the European Treaties was guaranteeing lasting peace through market integration under rules of free and fair competition. Today that lasting peace between the member states is a “fait accompli”. The challenge now is how to protect peace and the welfare of the member states and the Union against existential threats from the outside like pandemics, climate change and immigration. In the light of the fact that spending power of the member states is fifty times higher than the spending power of the union, the argument of a threat by the EU to national fiscal sovereignty rings quite hollow.

Regardless which procedure is followed changing the European Treaties requires the approval of all 27 member states. Amending the European Treaties is now not on the agenda for the approval of the multiannual financial framework (2021-2027). But as the understanding of future threats and challenges for the member states and the Union will be growing and will become much clearer, now is the right time for tax academics to study the issues involved in such treaty amendments in order to be ready seven years from now, when the next multiannual financial framework for the EU will be decided.

Is there a short cut to EU taxes?

However there may be a short cut to European taxes in the form of environmental levies. Art. 192. 2a TFEU authorizes the EU to take initiatives regarding the environment including “provisions of a fiscal nature”. The proposal for the multiannual financial framework under discussion today, refers to an extension of the “own resources” that feed the EU budget in particular in the area of environmental levies: carbon border adjustments for imported goods, extension of the trading system for carbon emissions to aviation and navigation and a CO2 tax. These are levies that should be applied in a uniform way throughout the Union to avoid distortions in competition. Making these levies a direct contribution to the EU budget would also avoid the allocation problem of the tax revenue to the national budgets of the member states.

The final problem is that this proposal would change the existing system of “own resources” used for financing the EU budget. Art. 311 TFEU states: “The Union shall provide itself with the means necessary to attain the objectives and carry through its policies.” In fact however, the lion’s share of the EU budget consists of payments from the national budgets of the member states to the budget of the Union. The decision to establish new categories of own resources lies with the Council of Ministers deciding by unanimous vote. That unanimity rule may be changed however in a qualified majority rule with co-decision of the EU parliament, specifically for environmental provisions of a fiscal nature. That leaves an opening for a political compromise for truly European taxes as own resources for budget.

Conclusion: a long term and a short term research project on a Roadmap for a new EU budget:

The last few weeks, locked down in their different member states some EATLP tax colleagues have been participating in various online discussions on these issues. The outcome has been two research

projects on a new Roadmap for an EU Budget. One long term project on a reform of the European Treaties dealing with a new role for the EU budget with direct financing by separate and independent EU taxes. This research project exceeds our competence as tax professors, because it also involves institutional problems of EU community law, economic and financial problems of operating an Economic Union with a common currency, budgetary problems but finally also tax problems relating to the selection of taxes for the budget, the scope and the base of those taxes and the administration of those taxes. The goal of that project is to contribute a final report that would clarify the issues and provide alternatives so as to facilitate democratic political decision making, which in the end should have the last word. The European Association of Tax Law Professors has offered to provide a platform for this research project.

There is also the idea of another research project on the short cut proposal of the Commission to change the rules for the own resources for the multiannual financial framework (2021-2027). That project would also cover institutional problems of how to adapt the rules on own resources so as to allow environmental levies and which specific taxes would best fit in this approach. This project is more urgent, as the conclusions should be available before the end of this year.

These two projects are an appeal to all members of the EATLP. Building the EU is a continuing project and a common responsibility, not only of professional politicians, but of all fellow Europeans including European tax academics . As tax academics it is our duty to reflect, to study and to find solutions on the role of taxation in the confrontation with the fundamental challenges to our common European destiny.