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# A Democratic Dilemma of European Power to Tax: Reconstructing the Symbiosis Between Taxation and Democracy Beyond the State?

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(Received 30 May 2018; accepted 05 July 2019)

## Abstract

In Western capitalist societies, the three postwar decades witnessed a strong interconnection between income taxation and democracy. On the one hand, the democratically representative political process constituted a precondition for the legitimacy of taxation. On the other hand, redistributive income taxation enhanced conditions for equal democratic participation by allocating resources and equalizing political power among citizens. The asymmetric European integration that has advanced transnationalization of cross-border market order but preserved income taxation under national political authority has established fiscal interdependence between Member States of the EU and exposed them to transnational regulatory effects. As a result, Member States' performance to uphold the symbiosis between democracy and taxation has eroded. While this has led some to call for further integration of taxes beyond the nation state, others have remained skeptical about the democratic legitimacy of Europeanized taxation. This Article argues that the Europeanization of income taxation would help to reconstruct the conditions under which the symbiosis between income taxation and democracy is restored, although this requires the notion of democratic community to be reinterpreted according to the standards that cannot be equated with nation-based boundaries of a political community.

**Keywords:** Fiscal democracy; European tax integration; tax autonomy; redistribution

## A. Introduction

In the context of European integration, the issue of democracy arises in two basic respects. First, it is questionable whether the European Union (EU) may be considered to constitute a democratic community—either in the present or eventually in the future.<sup>1</sup> On the one hand, this issue concerns the legal design of the Union and its compliance with the standards of democratic institutions. On the other hand, it revolves around the social structure of Europe and the possible existence of European civil society—demos or comparable political collective—which is perceived as an indispensable precondition for European democracy. Second, it can be debated whether and how the EU influences the democratic processes within national polities, which have routinely been conceived as democratic entities. The latter question suggests, in particular, that observing whether and in what fashion the politico-legal development of the Union undermines the

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<sup>1</sup>See Michael Th. Greven, *Can the European Union Finally Become a Democracy?*, in *DEMOCRACY BEYOND THE STATE? THE EUROPEAN DILEMMA AND THE EMERGING GLOBAL ORDER* 35, 37–39 (Michael Th. Greven & Louis W. Pauly eds., 2000).

preexisting democratic traditions within its Member States.<sup>2</sup> Therefore, it is not about the prospects of a single democratic body in Europe but about the dismantlement of multiple, already existing, democracies. Nonetheless, the issues become intertwined when one promotes “more Europe”—in essence calling for more fundamental powers to be conferred upon the Union—intending to remedy the deficiencies that integration itself generates. Indeed, this provokes the question of whether credentials exist for the EU to become a democratically legitimate bearer of more voluminous public or regulatory authority.

In the pluralistic scenery of normative orders, national exercise of public authority is shaped in the interplay between domestic and European law. In consequence, the assessment of democratic legitimacy of state practices compels us to remain observant to domestic—as well as European—normative sources. This consequence has become reality even in the most salient and conventionally state-centered branches of governance. In spite of the commonly heard customary wisdom that Member States have retained their unfettered sovereignty to tax, the power to tax makes no deviation from this common trajectory. The regulation of taxation has exceedingly taken place at the European level, even though Member States have preserved their capacities to administrate and raise taxes.<sup>3</sup> Moreover, not all European legal standards that influence the national exercise of the power to tax are directly tax-related so that they would make formal normative claims on tax systems. Rather, they are general market-building norms that are inclined to cause factual and indirect consequences for national fiscal self-determination and for effective political discretion. As a result, observations should comprehensively take into account both domestic and European normative sources when considering the democratic legitimacy of contemporary exercises of the power to tax within national polities.

The present Article examines how national interconnection between democracy and income taxation has declined in the course of European integration and whether the EU itself would be in a position to provide remedies. The first Section identifies the development of two primary constituents of national symbiosis between taxation and democracy: Representative politics of democratic tax law-making—procedural essential—and democracy-enhancing intention of income taxation—substantive essential. These observations describe the national environment against which the influence of European integration will be examined. The second Section of this Article observes the effects of European integration on domestically evolved fiscal traditions. The Section demonstrates how the deep-reaching European market-building and concurrent absence of Europeanized income taxation—that is, the asymmetric architecture of the European economic constitution—has dismantled the democratic groundwork of Member States’ income taxation by establishing interdependencies between regulatory systems. The third Section considers the future prospects of European tax integration and the more profound incorporation of income taxation into the European economic constitution. Some scholars confront further tax integration with skepticism because the EU allegedly suffers from a democratic deficit, and income taxation is in need of heightened democratic legitimation. Without committing to the skeptical attitude, the third Section reflects on whether European governance of income taxation might eventually enjoy democratic legitimacy.

This Article sets out a three-part argument. First, it asserts that the postwar social contract represented a strong interconnection between income taxation and democracy. Second, it posits that European economic integration has mutated the circumstances under which this symbiosis between income taxation and democracy could be upheld. Third, it argues that Europeanized income taxation would help to reconstruct the conditions under which the symbiosis between

<sup>2</sup>Fritz. W. Scharpf, *Economic Integration, Democracy and the Welfare State*, 4 J. EUR. PUB. POL’Y 18, 19–23 (1997).

<sup>3</sup>Philipp Genschel & Markus Jachtenfuchs, *How the European Union Constrains the State: Multilevel Governance of Taxation*, 50 EUR. J. POL. RES. 293, 293–94 (2011); Philipp Genschel & Markus Jachtenfuchs, *The European Integration of Core State Powers. Patterns and Causes*, in BEYOND THE REGULATORY POLITY? THE EUROPEAN INTEGRATION OF CORE STATE POWERS 249, 250–55 (Philipp Genschel & Markus Jachtenfuchs eds., 2013).

income taxation and democracy is restored; although, this requires that the notion of democratic community is reinterpreted according to the standards that cannot be equated with nation-based boundaries of a political community.

## B. Two Essentials of National Symbiosis Between Income Taxation and Democracy

Taxation and democracy stand in a reciprocal relationship. On the one hand, the democratic political process is a precondition for justified taxation and contributes to the legitimacy of taxation—procedural essential. On the other hand, taxation itself enhances credentials for democracy and reinforces the conditions for a factual realization of democratic practices within civil society—substantive essential.<sup>4</sup> The bidirectional relationship illustrates the position of taxation within social reality in general. The fiscal system does not only reflect—as a symptom and an effect—the extant social circumstances, but it also brings about—as a cause and transformative force—societal consequences.<sup>5</sup> This Section examines how representative democracy emerged as a procedural prerequisite for the legitimate power to tax. Moreover, the Section considers how taxation was harnessed to function as a redistributive instrument in pursuance of equality and therefore as a means to bolster the deliberative and participatory constituents of democracy.

### I. Democratic Representation as a Precondition for the Legitimacy of Taxation

The dictum “no taxation without representation” serves as one of the most distinguished constitutional principles referencing taxation. American colonists made the declaration famous while protesting against taxes imposed on them by British parliament—whose members the colonists were not entitled to elect and where the colonists had no representation. By the middle of the eighteenth century, the core content of the principle had already become settled and almost notorious.<sup>6</sup> The bottom line of the demand was voiced with a clear articulation in John Locke’s political philosophy, where Locke wrote:

[T]he supream [sic] power cannot take from any man any part of his property without his own consent. [G]overnment into whatsoever hands it is put . . . can never have a power to take to themselves the whole or any part of the [subject’s] property, without their own consent. . . . ‘Tis true, governments cannot be supported without great charge, and ‘tis fit every one who enjoys his share of the protection, should pay out of his estate his proportion for the maintenance of it. But still it must be with his own consent, i.e. the consent of the majority, giving it either by themselves, or their representatives chosen by them. For if any one shall claim a power to lay and levy taxes on the people, by his own authority, and without such consent of the people, he thereby invades the fundamental law of property, and subverts the end of government.<sup>7</sup>

The normative coupling of taxation and representation asserts a procedural condition for legitimacy. Justified extraction of revenues through taxation necessitates that those who are liable to taxes consent to their imposition and consent happens, in effect, through representatives. Consent-based taxation requires that the source for authorization to collect taxes does not reside

<sup>4</sup>See Peter Dietsch & Thomas Rixen, *Global Tax Governance: What It is and Why It Matters*, in *GLOBAL TAX GOVERNANCE: WHAT IS WRONG WITH IT AND HOW TO FIX IT* 1, 10 (Peter Dietsch & Thomas Rixen eds., 2016).

<sup>5</sup>See Isaac William Martin, Ajay K. Mehrotra & Monica Prasad, *The Thunder of History: The Origins and Development of the New Fiscal Sociology*, in *THE NEW FISCAL SOCIOLOGY. TAXATION IN COMPARATIVE AND HISTORICAL PERSPECTIVE* 1, 2–3 (Isaac William Martin, Ajay K. Mehrotra & Monica Prasad eds., 2009).

<sup>6</sup>JEAN-JACQUES ROUSSEAU, *DISCOURSE ON POLITICAL ECONOMY AND THE SOCIAL CONTRACT* 25–42 (Christopher Betts trans., Oxford Univ. Press 1999) (1755).

<sup>7</sup>JOHN LOCKE, *TWO TREATISES OF GOVERNMENT* 360–62 (Peter Laslett ed., Cambridge Univ. Press 1988) (1690).

beyond taxpayers but resides in the citizens themselves. Citizens affected by the adoption of taxes are represented in parliamentary proceedings, thereby participating in the political process through which taxes are instituted. In this sense, citizens are not taxed by the government or the Crown, but rather they tax themselves.<sup>8</sup> In substantive terms, the act of consenting to taxation establishes public authority, as it generates governmental power to impose taxes on individual citizens. In contemporary vocabulary, the assertion of consent demonstrates a call for representative democracy: The proclamation “no taxation without representation” requires taxpayers to have representation in a political process through which the power to impose taxes is constituted. In the course of the modern era, the pairing of taxes and representation contributed to the rise and extension of parliamentary assemblies in Europe.<sup>9</sup> Indeed, because tax laws were the very early statutes to require acquiescence by their subjects, the demand for participation extended into other fields of legislation and invigorated the ethos of representative democracy.<sup>10</sup>

Towards the twentieth century, the demand for representative politics of taxation revealed how rudimentarily it had materialized. In many Western countries, suffrage was dependent on certain personal possession of wealth or level of income, which constituted a formal linkage between the political and the economic. Still, in the nineteenth century, the bulk of revenues were generated by consumption taxes, whose burden fell upon propertied—as well as non-propertied—classes of society.<sup>11</sup> As the latter made up the vast mass of taxpayers, the majority was subjected to taxation without having representation. Taxes burdened lower-income citizens more severely than higher-income citizens because of the regressive effect of indirect taxes. This negative outcome induced pressures for more inclusive enfranchisement of populace and reformation of parliamentary organs.<sup>12</sup> In the study of public finance, Knut Wicksell articulated that tax legislation may not—without further procedural qualifications—always express the will of majority, and this most definitely does not happen “where the whole legislative and tax approval machinery still lies exclusively in the hands of the propertied classes.”<sup>13</sup> The eventual inception of inclusive suffrage introduced a genuine representative national democracy—as the great majority of citizens obtained a right to vote and became entitled to have representation, irrespective of socio-economic class.

The adoption of universal suffrage abolished the incongruence that previously prevailed between the tax burden and the lack of representation. Furthermore, the enfranchisement of the majority of citizens marked the legal decoupling of political citizenship and economic status, which contributed to the formal autonomy of representative politics in respect to personal economic circumstances. Gradually, the national demos—or aggregate of citizens—became the collective political subject of fiscal democracy: Transition from the rule by the propertied minority to the popular self-rule was taking place—at least in formal or legal terms. On the one hand, political power became a genuinely democratic power, as it was vested in the inclusive body of citizens. On the other hand, the boundaries of a political community were stringently drawn on the basis of

<sup>8</sup>In the context of land taxes, excises, and customs duties, the phrase “people taxing themselves” was used by Immanuel Kant and refers to imposing taxes through the deputies. Immanuel Kant, *Die Metaphysik der Sitten*, in *WERKE IN SECHS BÄNDEN. BAND IV: SCHRIFTEN ZUR ETHIK UND RELIGIONSPHILOSOPHIE* 445 (Wilhelm Weischedel ed., 2016) (1797).

<sup>9</sup>For this argument, which has been relatively dominant in the historical scholarship on fiscal and political institutions, see Michael L. Ross, *Does Taxation Lead to Representation?*, 34 *BRITISH J. POL. SCI.* 229, 230–36 (2004).

<sup>10</sup>ROBERT DAHL, *ON DEMOCRACY* 22 (2000).

<sup>11</sup>For thorough analyses of European countries in this respect, see *PAYING FOR THE LIBERAL STATE: THE RISE OF THE PUBLIC FINANCE IN NINETEENTH-CENTURY EUROPE* (José Luís Cardoso & Pedro Lains eds., 2010).

<sup>12</sup>Michael Herb, *Taxation and Representation*, 38 *STUD. COMP. INT’L DEV.* 3, 22 (2003).

<sup>13</sup>Knut Wicksell, *A New Principle of Just Taxation*, in *CLASSICS IN THE THEORY OF PUBLIC FINANCE* 72, 87, 89–90, 95, 117–18 (Richard A. Musgrave & Alan T. Peacock eds., James M. Buchanan trans. 1958) (1896). Wicksell’s observations were closely related to then-contemporary concerns that enfranchised masses would—by the tyranny of the poor majority—burden the rich with unreasonable taxes, for which reason Wicksell adopted the balancing rule of approximately unanimous decision-making. For this debate, see Florian Schui, *Zum Begriff des Steuerstaats*, in *SPRACHVOLLZUG IM AMT. KOMMUNIKATION UND VERWALTUNG IM EUROPA DES 19. UND 20. JAHRHUNDERTS* 107, 118–26 (Peter Becker ed., 2011).

national belonging. Consequently, all citizens should be entitled to participate in the adoption of taxes, which constitutes the procedural essential in the symbiosis between taxation and democracy.

## II. Redistributive Taxation as a Precondition for Equal Democratic Participation

The comprehensive enfranchisement of citizenry and the democratization of tax law-making contributed to the material transformation of the systems of taxation—now harnessed to serve more diverse intentions.<sup>14</sup> Since the turn of the twentieth century, taxation was exceedingly employed to reinforce social policies; taxation was not used solely for a fiscal purpose. In turn, this Article will depict the transition from fiscally oriented taxation to its more varied functioning. It was precisely this transition that complemented the already existing connection between taxation and representative democracy.

The above cited passage regarding the Lockean rule of representative politics of taxation describes a certain instrumental function assigned to taxation. According to Locke, government duties cannot be performed without spending, and taxes—as charges on citizens—are utilized to cover the expenses: They serve the fiscal purpose of financing the government. Furthermore, the public assignments entrusted to the government relate—in the Lockean mindset of the contained government—to the protection of inviolable rights to private property, which amounts to maintaining internal and external security.<sup>15</sup> The confined function of providing for public goods and for the most basic administrative tasks remained imperative for the teleological legitimacy of taxation for the subsequent two centuries. During this era, taxation allocated resources in a vertical relationship between state and citizenry but was not intended to reshape the relative economic standings between individuals in a horizontal dimension. The doctrine of tax neutrality—as interpreted back then—prescribed that taxation should leave individuals in the same comparative standing in which they resided, in relation to each other, prior to taxation.<sup>16</sup> Consequently, neutrality safeguarded the formal equality of taxpayers. The same doctrine of equality was witnessed in reference to the fair allocation of tax burden: Just as the public provision of goods—for which taxes were perceived as counter-performances—was conceived to benefit evenly each member of a political community, the tax burden was also proportionately distributed between them.<sup>17</sup>

The fiscal intention was a product of the specific historical context of taxation. Modern constitutional thought of classical liberalism instigated a functional separation between the public and private sphere and—as a result—the demand for the state's non-interference in the private realm became uncompromising. The state—as a bearer of public authority—was constrained by constitutional norms, and therefore it acted under the principle of constitutional boundedness, whereas the society of private citizens organized itself under the principle of liberty.<sup>18</sup> As long as individual and negative liberty rights were not obstructed by others, the liberal state refrained from intervening in society—which was now deemed to constitute itself according to the principle of self-organization.<sup>19</sup> The nineteenth century institutionalization of the private economy as a free

<sup>14</sup>Indeed, democratization has been considered one of the principal reasons for these changes. See SVEN STEINMO, *TAXATION AND DEMOCRACY: SWEDISH, BRITISH AND AMERICAN APPROACHES TO FINANCING THE MODERN STATE* 21–23 (1993).

<sup>15</sup>LOCKE, *supra* note 7, at 324–25, 350.

<sup>16</sup>FRITZ KARL MANN, *STEUERPOLITISCHE IDEALE: VERGLEICHENDE STUDIEN ZUR GESCHICHTE DER ÖKONOMISCHEN UND POLITISCHEN IDEEN UND IHRES WIRKENS IN DER ÖFFENTLICHEN MEINUNG 1600–1935*, 246–47 (1937).

<sup>17</sup>CAROLYN WEBBER & AARON WILDAVSKY, *A HISTORY OF TAXATION AND EXPENDITURE IN THE WESTERN WORLD* 339 (1986).

<sup>18</sup>Dieter Grimm, *Ursprung und Wandel der Verfassung*, in *DIE ZUKUNFT DER VERFASSUNG II: AUSWIRKUNGEN VON EUROPÄISIERUNG UND GLOBALISIERUNG* 11, 31 (2012).

<sup>19</sup>See FRANCOIS EWALD, *DER VORSORGESTAAT* 63–88 (Wolfram Bayer & Hermann Kocyba trans., 1993).

market order was a distinct example of this: By imposing taxes, the state was not to intervene in the outcomes of the markets but to reproduce the preconditions for liberal capitalism and to guarantee the unhindered functioning of the market mechanism for the distribution of resources.<sup>20</sup> Market outcomes resulting from the spontaneous and natural ordering of the economy were left intact because no normative standards for distribution existed against which the state could rearrange the market outcomes and provide an alternative for the market-internal yardstick. Provided that taxation engaged in trans-fiscal endeavors, it would indeed, according to the liberal understanding of the state, “subvert the end of government,” as noted by Locke.

The gradual transition from the nineteenth century liberal state to the varied models of the welfare state marked the restructuring of a nexus between public and private domains. The rigid doctrinal differentiation between state and society was called into question, as the former began to exceedingly penetrate the reproduction of the latter.<sup>21</sup> Previously, the private market order—if only delivered to unfold autonomously—was declared to yield acceptable economic outcomes in its own right. The material consequences of the order—built on the principles of formal equality and liberty that reminded of the eradication of former class privileges established through legal order—proved to be adversarial, as the self-governing society was provoking social and factual inequalities between individuals. In order to redress the transpiring “social deficit,” the state acquired a new and positively defined presence in society.<sup>22</sup> Previously, the markets were experienced as a nature-like and self-sufficient social system that resided beyond public interventions. From now on, the capitalist order began to appear as a politico-legal construction whose controversial outcomes could be attributed to political decisions. Meanwhile, the state emerged as a mechanism for compensating and correcting the disadvantages brought about by the market order—whose end results previously fell beyond state interference. This resulted in social policies derived from market-external standards of social justice and introduced to balance the consequences of the political choice to set up the economy as a free market order.<sup>23</sup> Echoing Karl Polanyi’s vocabulary,<sup>24</sup> the market economy that was once disengaged from its external institutions became re-embedded in the market-transcendent social aspirations, now carried on by the state.

In concrete terms, the change in the interaction between the public and the private was witnessed in the transfigured duties of the state and taxation. In the aftermath of World War I—and even more so after World War II—taxation began to equalize economic inequalities emerging under the capitalist system. Because the market order was not perceived as a natural and sacrosanct condition of society, but as an element in a politically established economic constitution, taxation—as another facet of that constitution—was not confined to show unfaltering deference to the market-produced distribution of goods but could legitimately be utilized to rearrange it. The criterion of equality was not reduced to market-based allocation but to a more overarching conception of social justice reinforced—among other means—through taxation.<sup>25</sup> The equality-enhancing ethos is recognizable at least in four respects. First, pervasive adoption of income taxation accommodated individual tax burdens to specific personal circumstances.

<sup>20</sup>JÜRGEN HABERMAS, *LEGITIMATION CRISIS* 36 (Thomas McCarthy trans., 1975).

<sup>21</sup>See ERNST-WOLFGANG BÖCKENFÖRDE, *DIE VERFASSUNGSTHEORETISCHE UNTERSCHIEDUNG VON STAAT UND GESELLSCHAFT ALS BEDINGUNG DER INDIVIDUELLEN FREIHEIT* 37–39 (1973).

<sup>22</sup>Dieter Grimm, *Bürgerlichkeit im Recht*, in *RECHT UND STAAT DER BÜRGERLICHEN GESELLSCHAFT* 11, 45–47 (1987); Wolfgang Abendroth, *Zum Begriff des demokratischen und sozialen Rechtsstaates im Grundgesetz der Bundesrepublik Deutschland*, in *RECHTSSTAATLICHKEIT UND SOZIALSTAATLICHKEIT* 114, 119 (Ernst Forstthoff ed., 1968).

<sup>23</sup>WOLFGANG KERSTING, *WIE GERECHT IST DER MARKT? ETHISCHE PERSPEKTIVEN DER SOZIALEN MARKTWIRTSCHAFT* 22, 28 (2012).

<sup>24</sup>KARL POLANYI, *THE GREAT TRANSFORMATION: THE POLITICAL AND ECONOMIC ORIGINS OF OUR TIME* 57 (1957).

<sup>25</sup>For a philosophical explication of this argument, see LIAM MURPHY & THOMAS NAGEL, *THE MYTH OF OWNERSHIP: TAXES AND JUSTICE* 8, 36–37 (2002). From a more historical perspective, see KENNETH SCHEVE & DAVID STASAVAGE, *TAXING THE RICH: A HISTORY OF FISCAL FAIRNESS IN THE UNITED STATES AND EUROPE* 24–49 (2016).

Second, the fair allocation of the tax burden between taxpayers increasingly followed the principle of the ability to pay or that of equal sacrifice. This was one of the background reasons for progressive taxes on income as well as on inheritance. Third, taxation reinforced the intention of redistributing wealth between citizens: Instead of sanctifying the pre-tax distribution, taxation was deliberately harnessed to restructure the horizontal economic positions of individuals; this purpose was partly autonomous from the revenue-raising intention. Fourth, revenues collected through taxation were exceedingly utilized to finance the public provision of the welfare state—a provision that could not be equated with the nineteenth century supply by the restrained state. As lower-income citizens were inclined to benefit more from the new modes of the public provision, taxation indirectly contributed to unforeseen redistributive effects.<sup>26</sup> As a result, taxation evolved into a redistributive means of governance and aspired to produce effective social equality between the citizens of a national polity.

The redistributive intention of income taxation bears particular relevance in the context of political citizenship, as the egalitarian allocation of resources is considered one of the cornerstones of political equality and democracy in much of the recent political thought. Taxation serves as an instrument for reinforcing the demand for relative equality in political power because differences in individual economic resources typically breed imbalance in interests as well as in opportunities for political participation, deliberation, and influence.<sup>27</sup> Without a doubt, this is in continuity with the nineteenth century separation of the political and the economic: While the formal bond between wealth and participation was earlier alleviated through universal enfranchisement, taxation now strived to decrease the factual dependence of the political on the economic. Resembling the more overarching turn from formal interpretation of individual liberties towards the conditions of their factual realization, political participation also came to be understood in a more concrete and full-bodied fashion. As a result, taxation was designed to empower citizens whose market citizenship provided scant resources with which to realize their political citizenship through participatory and deliberative facets of democracy. Consequently, income taxation—as a device for equalizing political power—essentially contributed to the balance between the capitalist economy and democratic politics in the postwar social settlement. This constitutes the substantive essential in the symbiotic relationship between taxation and democracy.

In order to conclude on the reciprocal relationship between taxation and democracy in the nation-state context, three aspects should be re-emphasized. First, participation through representation is a procedural precondition for the legitimate imposition of taxes in a vertical relation between the state and the individual. As the represented constituency of taxpayers has evolved to comprise the vast majority of citizens belonging to a civic community of the nation-state, the national demos may be regarded as a political collective for fiscal democracy; this provides credentials to perceive taxation as an issue of genuinely representative national democracy. Second, income taxation developed into an instrument of redistributive politics, which contributed to equality of political power among the members of a national democratic polity. Hence, income taxation is not only based upon democratically legitimate processes, but it also enhances democratic processes and conditions for participation within egalitarian democracies.<sup>28</sup> Third, the redistributive intent altered and diversified the substance of the politics of taxation. Enacting tax law is not only about consenting to finance public functions—in a vertical relationship between the government and the governed—but also about reshaping the relative economic stances of

<sup>26</sup>The extent to which redistributive policies are enforced directly through taxation—or indirectly through spending and state provision of goods—varies across the countries. See STEINMO, *supra* note 14, at 2–3.

<sup>27</sup>See JOHN RAWLS, *A THEORY OF JUSTICE* 242–51 (rev. ed. 1999); MICHAEL WALZER, *SPHERES OF JUSTICE: A DEFENSE OF PLURALISM AND EQUALITY* 119–23 (7<sup>th</sup> ed. 1996).

<sup>28</sup>Consequently, postwar tax systems reinforce the dependent conception of democracy. The conception claims that democratic decisions enhance conditions for democratic participation and may not be reduced to the legitimacy of being adopted in a democratically arranged political procedure—in a due process of representation. See RONALD DWORKIN, *SOVEREIGN VIRTUE: THE THEORY AND PRACTICE OF EQUALITY* 185–90 (4<sup>th</sup> ed. 2002).

individuals—in a horizontal relation between the citizens. As a political issue, income taxes were not only consent-based counter-performances for publicly provided benefits, but they were also one fraction in a more overarching settlement on legitimate social order and fair distribution of goods. Economic organization became—to the core—politicized, instead of an autonomous ordering of the economic sphere as such constituting a background for political participation. The economic sphere did not dictate the prospects of democratic participation, but the economy itself was placed under democratic control. Indeed, the domestic economic constitution became inseparably embedded into the social and political dimensions of constitutional thought.

### C. Consequences of European Integration for National Politics of Taxation

In the global political economy, the somewhat shared experience that income taxation is under-governed beyond the state level prevails: While cross-border market order has undergone deep integration, national systems of taxation have not been harmonized.<sup>29</sup> The resulting coexistence of cross-border economic mobility and national autonomy to design taxes facilitates a tax arbitrage, which undermines the national symbiosis between taxation and democracy. The EU, however, has ventured towards governing income taxation. The present Section observes the historically evolved trajectories of income tax integration and recognizes their dominant characteristics. This Section discerns that the European tax policy has evolved between tax and market considerations. It identifies the extent to which European tax governance has countervailed the alleged consequences of imbalanced integration of markets and taxes. Generally, this Section appreciates the fashion in which European integration has contributed to the reconfiguration of the symbiotic coexistence of taxation and democracy, which has developed in the nation-state context.

#### I. Trajectories of European Income Tax Integration

The first three decades in the existence of the European Communities were characterized by two-tiered tax integration: While removal of intra-community customs duties and approximation of indirect taxes proceeded, integrated income taxes remained absent. In spite of several initiatives designed to regulate capital and corporate taxation, the efforts did not result in the Europeanization of income tax systems but remained unaccomplished visions.<sup>30</sup> From the perspective of market integration, the disparity of national systems was contemplated as a potential impediment to the functioning of the common market, much like unharmonized indirect taxes.<sup>31</sup> The acceptability of the market-advancing alignment of taxes was, however, predicated on the condition that harmonization would not hamper Member States' capacities to use taxation for their chosen ends.<sup>32</sup>

From the viewpoint of taxation, the approximation of tax systems was not inevitable with respect to assuring their performance and effectiveness. The early phase of integration was shaped by the determination that then-imagined stages of market integration would not undermine the

<sup>29</sup>For an elaboration on this argument, see Jussi Jaakkola & Reijo Knuutinen, *The International Order of Corporate Taxation: From Market-Building to Sustainable Fiscal Settlement?*, in CAMBRIDGE HANDBOOK OF CORPORATE LAW, CORPORATE GOVERNANCE AND SUSTAINABILITY (Beate Sjäfjell & Christopher M. Bruner eds., forthcoming 2020).

<sup>30</sup>See PHILIPP GENSCHEL, *STEUERWETTBEWERB UND STEUERHARMONISIERUNG IN DER EUROPÄISCHEN UNION* 128–41, 156–89 (2002); A. J. EASSON, *TAXATION IN THE EUROPEAN COMMUNITY* 184–88 (1993).

<sup>31</sup>European Economic Community, *Tax harmonization programme. Programme for the harmonization of direct taxes*, 1967 J.O. (EC). See also CLEMENS KAUPA, *THE PLURALIST CHARACTER OF THE EUROPEAN ECONOMIC CONSTITUTION* 52 (2016).

<sup>32</sup>See *Commission's Action Programme for Taxation*, at 1–2, COM (75) 391 final (July 23, 1975). See also Agustín José Menéndez, *Neumark Vindicated: The Three Patterns of Europeanisation of National Tax Systems and the Future of the Social and Democratic Rechtsstaat*, in *THE END OF THE EUROCRATS' DREAM: ADJUSTING TO EUROPEAN DIVERSITY* 78, 81–82 (Damian Chalmers, Markus Jachtenfuchs & Christian Joerges eds., 2016).



viability of national tax systems, provided that their design was formally preserved under national authority. Integration was grounded on the expectation of economic prosperity, which was to follow from the opening of national economies and to take place side by side with constituting national social regimes through taxation within states, where the benefits were to be accrued and taxed.<sup>33</sup> Market integration was not considered contradictory to the interventionist nation-state but to its transnational counterpart: It was envisaged to contribute—in a constructive fashion—to the postwar reconstruction of states by unraveling interdependencies.<sup>34</sup> In a more global context, this was the experience of “embedded liberalism,” under which liberalization of trans-border economic order was embedded in the concurrent demand for nation-states to remain able to preserve their factual autonomy to conduct tax and social policies without external constraints.<sup>35</sup> This legitimized the absence of European income tax integration.

During the 1980s, there was change of course in European tax integration: Whereas the earlier phase of integration kept systems of income taxation intact, they were now gradually becoming regulated under European legal authority. In the first instance, this took place by accommodating national tax systems into the four economic freedoms—time-wise related to the “internal market” as a new legal paradigm for the European market order. Furthermore, accommodating taxation to the demands of cross-border economic movement reflected the doctrinal sentiment that taxation was a hindrance and a disincentive for market activities, which required its consolidation—both domestically and transnationally—according to the principle of economic effectiveness. The recasting of taxation to the demands of market integration took place in two essential instances. First, the European Court of Justice (“the Court”) began to rule on whether Member States’ income tax norms are in compliance with the gradually constitutionalized<sup>36</sup> economic freedoms of the treaties.<sup>37</sup> Judicial review revolved around the questions of: (1) Whether national tax practices discriminate against cross-border activities when compared with domestic ones; and (2) whether Member States’ norms constitute a restriction to the exercise of economic freedoms. Second, in the political mode of decision-making, three directives on income taxation were adopted in order to abolish impediments to cross-border corporate activities. In technical terms, the directives postponed taxation on corporate restructurings,<sup>38</sup> abolished chain taxation on corporate dividends,<sup>39</sup> and removed source taxation on intra-group interest and royalty payments.<sup>40</sup>

Regarding the nature of market-building through tax integration, certain characteristics define this process. First, the enforcement of the economic freedoms through judicial review evinces the deconstruction of domestically established public authority—namely, the states’ power to impose taxes. Once the exercise of state authority disadvantages cross-border economic actions, the excessive tax burdens as expressions of undue power to tax should be relinquished.<sup>41</sup> The same holds true for the directives, which confine the exercise of public authority. Second, accommodating

<sup>33</sup>MAURIZIO FERRERA, THE BOUNDARIES OF WELFARE: EUROPEAN INTEGRATION AND THE NEW SPATIAL POLITICS OF SOCIAL PROTECTION 90–95 (2005); KAUPA, *supra* note 31, at 27.

<sup>34</sup>ALAN S. MILWARD, THE EUROPEAN RESCUE OF THE NATION-STATE 1–45 (2000).

<sup>35</sup>John G. Ruggie, *International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order*, 36 INT’L ORG. 379, 393–98 (1982); ERIC HELLEINER, STATES AND THE REEMERGENCE OF GLOBAL FINANCE: FROM BRETTON WOODS TO THE 1990s 4–6, 25–77 (1996).

<sup>36</sup>See Joseph H. Weiler, *The Transformation of Europe*, in THE CONSTITUTION OF EUROPE: “DO THE NEW CLOTHES HAVE AN EMPEROR?” AND OTHER ESSAYS ON EUROPEAN INTEGRATION 10, 16–39 (1999); Dieter Grimm, *The Democratic Costs of Constitutionalisation: The European Case*, 21 EUR. L. J. 460 (2015).

<sup>37</sup>The first decision was ECJ, Case C-270/83, *Comm’n v. France*, ECLI:EU:C:1986:37, Judgement of 28 January 1986. The Court’s orientation, which proved to be persistent, was clearly stated in ECJ, Case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker*, ECLI:EU:C:1995:31, Judgement of 14 February 1995, para 21.

<sup>38</sup>Council Directive 434/1990, 1990 O.J. (L 225) (EC).

<sup>39</sup>Council Directive 435/1990, 1990 O.J. (L 225) (EC).

<sup>40</sup>Council Directive 49/2003, 2003 O.J. (L 157) (EC).

<sup>41</sup>See Michael Graetz & Alvin C. Warren Jr., *Income Tax Discrimination and the Political and Economic Integration of Europe*, 115 YALE L. J. 1186, 1223–24 (2006).

taxes to market concerns proceeded through negative integration.<sup>42</sup> Instead of positively constructing supranational tax norms, the Court and the Council both sporadically prohibited particular fiscal arrangements, which were to be removed from national normative orders. Third, although the furtherance of the markets through consolidating taxes has subjected national fiscal orders to European legal authority, it still leaves Member States with somewhat broad discretionary powers. While the few directives certainly prohibit specific tax arrangements that may not be sustained, the rulings by the Court provide Member States with a wide latitude to decide how to reconfigure their tax systems in order to remove the disadvantageous treatment encountered by cross-border economic activities.

Since the mid-1990s, income taxation systems have been brought under European legal authority from a perspective not reducible to the four economic freedoms. Whereas tax integration initially served to facilitate cross-border economic movement, integration became more balanced by aspiring to countervail the detrimental consequences of the established market order—erosion of national tax bases and distortions in equal conditions of competition. It was experienced that liberalization of capital mobility, in particular, was inclined to give rise to fiscal degradation among Member States.<sup>43</sup> The previous philosophy of tax integration no longer kept pace with the stages of economic integration reached through market-building. Ecofin established the Code of Conduct Group (Business Taxation) as an institutional corrective response to eroding tax bases and harmful tax competition.<sup>44</sup> The Group sought to abolish national tax base arrangements that favored certain taxpayers with undue advantages.<sup>45</sup> To the same effect, the European Commission applied state aid rules to recognize selectively provided fiscal benefits.<sup>46</sup> Because both measures focused on discriminatory and selective tax measures, they left much of the national tax base design intact: Member States remained free to tax or abstain from taxing, provided that tax treatment applied without favoring certain taxpayers. More recent endeavors against the erosion of income tax bases appeared in the aftermath of the Euro Crisis.<sup>47</sup> The European Council adopted a directive<sup>48</sup> addressing the consequences of tax avoidance. In principle, the directive represents an important qualitative change in the nature of income tax integration—it does not prohibit certain tax base designs but dictates which rules should be incorporated into national legislation. In a nutshell, one can observe a step towards the positive integration of Member States' tax systems.

What about the contention by international political economy scholarship that income taxation remains under-governed beyond the nation-state? Do the above presented routes of tax integration prove the contrary and demonstrate how income taxes have become absorbed into the European economic constitution? When compared with more a global integration of income tax systems, the EU has certainly gone further. Beyond the comparative perspective, however, the profoundness of income tax integration can hardly be affirmed.

In principle, tax integration has influenced many salient aspects of the income tax system design. Tax base structures have been subjected to both prohibitions and positive normative constructions at the European level. In spite of tax base design actualization, the extent to which these prohibitions and constructions have taken place is remarkably narrow. Moreover, Member States have a wide latitude in deciding how to remove discriminatory and selective tax measures.

<sup>42</sup>See Fritz. W. Scharpf, *Democratic Policy in Europe*, 2 EUR. L. J. 136, 142–43 (1996); FRITZ W. SCHARPF, GOVERNING IN EUROPE: EFFECTIVE AND DEMOCRATIC? 45 (1999); JAN TINBERGEN, INTERNATIONAL ECONOMIC INTEGRATION 122 (1954).

<sup>43</sup>See *Taxation in the European Union*, at 3–6, SEC (1996) 487 final (Mar. 20, 1996).

<sup>44</sup>Martijn Nouwen & Peter J. Wattel, *Tax Competition and the Code of Conduct for Business Taxation*, in EUROPEAN TAX LAW 927 (Peter J. Wattel, Otto Marres & Hein Vermeulen eds., 2019).

<sup>45</sup>Resolution of the Council and the Representatives of the Governments of the Member States of 1 December 1997 on a Code of Conduct for Business Taxation, 1998 O.J. (C 2) 3.

<sup>46</sup>See FRANCESCO DE CECCO, STATE AID AND THE EUROPEAN ECONOMIC CONSTITUTION 128–33 (2013).

<sup>47</sup>See Jukka Snell & Jussi Jaakkola, *Economic Mobility and Fiscal Federalism: Taxation and European Responses in a Changing Constitutional Context*, 22 EUR. L. J. 772, 779–86 (2016).

<sup>48</sup>Council Directive 1164/2016, 2016 O.J. (L 193) (EU).

Furthermore, the income tax rates have remained beyond European measures. Therefore, as the EU's capacity to subject state behavior to the authority of supranational law—and consequently inhabit the regulatory void or state of nature in the community of states—supports the EU's legitimacy<sup>49</sup>, this mode of legitimacy is not notably present in respect to income taxation—which is predominantly reproduced under the formal sovereignty of Member States.

## II. Fiscal Interdependence and the Symbiosis Between Taxation and Democracy

In the EU, one may encounter the existence of the profoundly integrated transnational market order and the concurrent absence of deep-reaching income tax integration. The asymmetric or fragmented integration between market and fiscal orders has constituted fiscal interdependence between Member States: Formal sovereignty to master income tax systems creates differentials between national orders, while enhanced economic openness provides mobile economic actors with an opportunity to locate and relocate in search of the most favorable fiscal treatment. Consequently, Member States become subject to transnational policy externalities, which transpire in two basic modes. In the case of fiscal externalities, tax bases migrate from one jurisdiction to another. In the case of regulatory externalities, states accommodate—in order to avoid the outflow of existing tax bases or to attract activities from abroad—their tax systems to preferences of mobile capital and corporations. In other words, Member States accommodate the demands of actors whose mobility has been advanced—to the fullest extent—through transnational economic order and who have consequently been granted an option of jurisdictional exits and entries. In so doing, states engage in regulatory rivalry, which has been claimed to have transformed Keynesian welfare regimes into competition states.<sup>50</sup>

The interconnectedness between income taxation and democracy—established in national polities as portrayed in the Section Two—has not remained unaffected by fiscal interdependence. The consequences of fiscal interdependence for Member States' fiscal traditions concern both the democratic preconditions for tax law-making and the democracy-enhancing capacities of taxation. Therefore, the procedural—as well as substantive—essential of a national symbiosis between taxation and democracy is affected. This has taken place in three steps.

First, the effects can be observed between national democracies. The democratic process of tax law-making has been restructured as the national polities are exposed to repercussions originating in foreign regulatory systems. As the citizens of nationally-bounded democratic communities do not possess representation in foreign polities—by whose political choices they are nonetheless affected—the democratic process becomes representatively under-inclusive.<sup>51</sup> As a result, there is an incongruence between representation and affectedness. While national democracies aspired to keep their formal income tax sovereignty intact in vertical relation to international organizations, income tax sovereignty has become factually constrained in a horizontal relation to other polities.<sup>52</sup> As transnational externalities constrain the exercise of the national democratic power to

<sup>49</sup>See Armin von Bogdandy, *Supranationale Union als neuer Herrschaftstypus: Entstaatlichung und Vergemeinschaftung in staatsrechtlicher Perspektive*, 16 *INTEGRATION* 210, 220–21 (1996).

<sup>50</sup>PHILIP G. CERNY, *THE CHANGING ARCHITECTURE OF POLITICS: STRUCTURE, AGENCY, AND THE FUTURE OF THE STATE* 53 (1990); Ronen Palan, *Tax Havens and the Commercialization of State Sovereignty*, 56 *INT'L ORG.* 151 (2002) (discussing this matter within the context of taxation).

<sup>51</sup>Agustín José Menéndez, *Another View of the Democratic Deficit: No Taxation without Representation*, in *WHAT KIND OF CONSTITUTION FOR WHAT KIND OF POLITY? RESPONSES TO JOSCHKA FISCHER* 125, 131–35 (Christian Joerges, Yves Mény & Joseph H. Weiler eds., 2000). To examine this argument more generally, see Michael Zürn, *Democratic Governance beyond the Nation-State*, in *DEMOCRACY BEYOND THE STATE? THE EUROPEAN DILEMMA AND THE EMERGING GLOBAL ORDER*, *supra* note 1, at 91, 92–94.

<sup>52</sup>For further discussion, see MATTHIEU ISENBAERT, *EC LAW AND THE SOVEREIGNTY OF THE MEMBER STATES IN DIRECT TAXATION* 62–63 (2010).

tax, the national community that was interpreted to constitute the political body for democratic tax law-making within Member States ceased to be the sole locus of power.

Second, the effects of interdependence can be experienced within national democracies or—in more precise words—between socio-economic classes of a particular polity. As the market integration and the option of territorial migration benefits and empowers the mobile economic actors as well as mobile factors of production,<sup>53</sup> the balance of interests within national democracies and among citizens has been reconfigured.<sup>54</sup> Consequently, the political influence is recoupled with economic standing—specifically with the status of high mobility—which has resulted in corresponding reallocation of political power. While the first three quarters of the twentieth century aspired to formal and effective decoupling of economic position and political power, the construction of transnational economic order has been somewhat counter-productive to those endeavors. This development stands in accordance with the renowned sociological diagnosis that democratic institutions remain formally extant while simultaneously becoming devoid of essential autonomy and authority. This occurs as the political power is effectively resettling to instances—and exercised through mechanisms—beyond practices inherent to the traditional ideal of democracy.<sup>55</sup> In tandem with the under-inclusiveness of national democracy, the unequal empowerment of socio-economic classes restructures the democratic process of tax law-making.

Third, the mutation of a political process—through which fiscal policies are decided—is inclined to translate into effects in national systems of taxation and their democracy-enhancing capacity. The adaptation of fiscal systems to the interests of transnationally mobile actors is expected to distort the patterns of downward redistribution and the allocation of fiscal burdens that have—in the postwar political compromise—been constructed in pursuance of socio-political equality, instead of capacitating actors according to their degree of cross-border mobility. In lieu of democratically controlling the market order through taxation, states have become—in their performance of governing the outcomes of markets and enhancing democracy through market-correcting taxation—domesticated by mobile market forces.<sup>56</sup> While classical liberalism subscribed to the doctrinal separation of the state from the economy, and while social democratic reasoning accepted the penetration of the state and politics into the sphere of economy—as demonstrated above in the context of taxation and emerging redistributive policies—the era of transnationalization has facilitated the penetration of the economy into the political sphere. This penetration consequently endangered the capacity of taxation to contribute to the equal allocation of resources and political power within society.

The emergence of fiscal interdependence between Member States and its consequences for national traditions of fiscal democracy appear reminiscent of the neo-functionalism notion of European integration: By unraveling interdependencies through market integration, new interdependencies are established through the spillover effect in non-integrated policy domains.<sup>57</sup> According to the thesis above, the new interdependencies have undermined the procedural—as well as substantive—essentials of national symbiosis between taxation and democracy. Moreover, although European integration has undermined Member States' performance in the field of income tax, the EU itself—as a federal sort of entity—has not provided corrective measures and has been only deficiently capacitated to perform complementary functions through

<sup>53</sup>Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1611–12, 1616–25 (2000).

<sup>54</sup>Sven Steinmo, *The End of Redistribution? International Pressures and Domestic Tax Policy Choices*, 37 CHALLENGE 9 (1994).

<sup>55</sup>See ULRICH BECK, *THE REINVENTION OF POLITICS: RETHINKING MODERNITY IN THE GLOBAL SOCIAL ORDER* 94–109 (1997); COLIN CROUCH, *POST-DEMOCRACY* 6 (2016).

<sup>56</sup>See SUSAN STRANGE, *THE RETREAT OF THE STATE: THE DIFFUSION OF POWER IN THE WORLD ECONOMY* 65 (1996).

<sup>57</sup>Philipp Genschel & Thomas Rixen, *Settling and Unsettling the Transnational Legal Order of International Taxation*, in *TRANSNATIONAL LEGAL ORDERS* 154, 154, 158 (Terence C. Halliday & Gregory Shaffer eds., 2015).

European institutions.<sup>58</sup> Consequently, what remains is the supranational integration of income taxation with the purpose of recapitulating Member States themselves and their democratic institutions through European regulations.<sup>59</sup> This would not require new European administrative institutions—like new tax collecting and spending capacities—nor the furtherance of the preexisting ones, but it instead requires European level norm-making that would re-empower national institutions. The second-generation interdependencies could be unraveled through farther-reaching transnational regulations because these would contain the regulatory competition among Member States.<sup>60</sup> In terms of political orientation, Europe is confronted with a choice: Whether to allow national policies being shaped in a state of anomic rivalry and ungoverned rampancy; or whether to deliberately construct them according to common European standards.<sup>61</sup> Indeed, the EU also faces the question of whether to reconstitute the viable symbiosis of taxation and democracy through supranational political authority, or let it develop in the state of indeterminacy.

#### D. Democratic Legitimacy of Integrating Income Taxation Beyond the State

Considering the side effects of European integration on the symbiosis between taxation and democracy, teleological grounds for supranational governance of income taxation exist. Conversely, income taxation and its regulation have traditionally been perceived to constitute an unalienable facet of national sovereignty.<sup>62</sup> Furthermore, they require heightened democratic legitimacy, which the EU cannot allegedly account for, unlike Member States with their national constituencies and democratic institutions.<sup>63</sup> Hence, national polities should remain the sole forum where politics of taxation take place. In tandem, the demands result in a deadlock: To revive the symbiosis between taxation and democracy, Member States should approve the democratic deficiencies from which politics of taxation beyond the state are proclaimed to suffer. The rescue of democracy would come with its demise. This Section explicates the facet of income tax regulation that constitutes the core for the basis which the material legitimacy of European politics of taxation should be assessed. It goes on to analyze whether institutional preconditions for representative legitimacy exist at the European level. The chief question is whether European political authority in income taxation would compel Member States to reimagine the constitutive essentials of legitimacy, which have been conceptualized as substantive and procedural essentials.

##### I. Redistribution and Substantive Legitimacy

The normative standards that the European legal order imposes on national systems of income taxation were analyzed earlier. The analysis reached a conclusion that market-building norms have predominantly abrogated domestically constituted power to collect taxes. Furthermore, market-correcting norms have not constituted the power to impose taxes. From this, one may

<sup>58</sup>William E. Oates, *Fiscal Competition and European Union: Contrasting Perspectives*, 31 REGIONAL SCI. & URB. ECON. 133, 142–43 (2001). For a general discussion on the “regulatory gap”, see Renaud Dehousse, *Integration v. Regulation? On the Dynamics of Regulation in the European Community*, 30 J. COMMON MARK. STUD. 383, 393–399 (1992).

<sup>59</sup>See Menéndez, *supra* note 32, at 118–19.

<sup>60</sup>For this argument, see Daniel Innerarity, *The Inter-Democratic Deficit of the European Union*, in BEYOND THE CRISIS: THE GOVERNANCE OF EUROPE’S ECONOMIC, POLITICAL, AND LEGAL TRANSFORMATIONS 173 (Mark Dawson, Henrik Enderlein & Christian Joerges eds., 2015) and Jürgen Neyer, *Europe’s Justice Deficit: Justification and Legitimacy in the European Union*, in POLITICAL THEORY OF THE EUROPEAN UNION 169 (Jürgen Neyer & Antje Wiener eds., 2011). For a general discussion on the argument, see Alexander Somek, *The Darling Dogma of Bourgeois Europeanists*, 20 EUR. L.J. 688 (2014).

<sup>61</sup>Jürgen Habermas, *The Postnational Constellation and the Future of Democracy*, in POSTNATIONAL CONSTELLATION: POLITICAL ESSAYS (Max Spensky ed. & trans.) 58, 97 (2011).

<sup>62</sup>See Diane M. Ring, *What’s at Stake in the Sovereignty Debate? International Tax and the Nation-State*, 41 VA. J. INT’L L. 155 (2008).

<sup>63</sup>ALICIA HINAREJOS, THE EURO AREA CRISIS IN CONSTITUTIONAL PERSPECTIVE 159–61 (2015).

be enticed to think that the determining line for legitimate European tax governance would be drawn by whether the EU establishes power to impose taxes—that is, whether it asserts public authority. The reasoning would echo the Lockean requirement of representative democracy as a precondition precisely for a legitimate obligation to contribute to the public purse. This argument would be somewhat incomplete. From indirect taxation, one learns that European legislation proceeded extremely far in terms of constituting state power—of which value-added tax is a representative—though not an exclusive—instance. The minimum value-added standard tax rate<sup>64</sup> obliges Member States to burden business sales—comprising a wide variety of market transactions—with no lower rate than fifteen percent. This figure is anything but insignificant and exceeds—for instance—the statutory corporate tax rate of several Member States. In this sense, the European economic constitution may be perceived as a source of public power for Member States. Consequently, the claim that the EU may not establish the power to impose taxes stands in manifest contradiction with legal reality.

Functional and practical reasons for advancing integration in the domain of indirect—but not in that of income—taxation may be multiple and intelligible. For instance, harmonization of indirect taxation was—from early on—considered crucial for the common market and free movement of goods.<sup>65</sup> From the perspective of legitimacy, however, a difference in the intentions of indirect and income taxation may constitute a pertinent reason for their incongruent regulation. While twentieth century national fiscal systems extensively instrumentalized income taxation for overtly redistributive purposes, they did not harness indirect taxes for that purpose. Consequently, the integration of income taxation at European level would both affect Member States' formal political latitude in issues of redistribution and have distributional repercussions within national polities. Against this backdrop, this Article asserts that the eventual root cause for why income taxation should resist Europeanization is—in regard to democratic legitimacy—its capacity to influence distributional patterns and relative socio-economic standings between individuals within Member States. In substantive terms—that is, regarding the material content of regulatory authority exercised by the EU—the question of income tax integration is not a unique and exclusive issue but intertwined with a broader discourse on whether the EU engages in politics of redistribution and whether it could do so in a legitimate fashion. Hence, debating the future furtherance of the European level democracy-enhancing capacity of taxation is somewhat tantamount to contemplating the legitimacy of European redistributive policies.

The initial phase of integration perceived redistributive policies as a national concern: While European integration was supposed to generate wealth and freedoms-based opportunities within the common market, Member States redistributed enhanced prosperity according to their domestic preferences.<sup>66</sup> The EU was not envisaged to undermine national patterns of redistribution but presumed—by respecting the division of labor between the Union and Member States—to leave distributive decisions to Member States, as Member States were democratically legitimized to make these decisions and institutionally furnished to enforce the said decisions. At the turn of the millennium, echoes of this original mindset were still observable in the debate on the European democratic deficit. Back then, Giandomenico Majone and Andrew Moravcsik famously argued that the democratic deficit may not be ascribed to the EU, as it does not exercise the kind of public authority that requires democratic legitimization. They drew a distinct separation between regulatory and redistributive policies and maintained that the EU has engaged only in the former, which are not politically salient enough to demand founding on democratic practices, as politics of

<sup>64</sup>The value-added tax rates—both standard and reduced rates—were adopted in 1992. See Council Directive 77/1992 supplementing the common system of value added tax and amending Council Directive 77/388/EEC, 1992 O.J. (L 316) (EC).

<sup>65</sup>Sijbren Cnossen, *Introduction*, in *TAX COORDINATION IN THE EUROPEAN COMMUNITY* 1, 6 (Sijbren Cnossen ed., 1987).

<sup>66</sup>FLORIS DE WITTE, *JUSTICE IN THE EU: THE EMERGENCE OF TRANSNATIONAL SOLIDARITY* 51–78 (2015); Floris de Witte, *The Architecture of a 'Social Market Economy'* (LSE Legal Studies, Working Paper No. 13, 2015), at 2. See also Kaarlo Tuori, *The Many Constitutions of Europe*, in *THE MANY CONSTITUTIONS IN EUROPE* 3, 16 (Kaarlo Tuori & Suvi Sankari eds., 2010).

distribution does.<sup>67</sup> Due to the specific mode and scope of public authority exercised by the EU, the missing democratic background process does not—according to Majone and Moravcsik—constitute a genuine deficit.

Since then, the unequivocal differentiation between non-distributive policies—enhancing opportunities equally for everyone—and distributive choices—directly benefiting some to the detriment of others—has been disputed. The history of European integration may not be equated with purely pareto-improving policies because it has tangible distributional consequences within Member States.<sup>68</sup> In more general terms, seeing the EU as a community of politically non-salient functions disregards its evolving nature.<sup>69</sup> The above-sketches emergence of fiscal interdependence may be considered a paramount example of how professedly neutral market-making policies end up having distributional repercussions both in terms of political power and material resources. Furthermore, since the eruption of the Euro Crisis, unprecedented forms of macroeconomic governance have brought about demands for austere measures that manifestly reconfigure national patterns of redistribution for the sake of eurozone economic stability.<sup>70</sup> In both cases—which are highlighted here only as examples extracted from a more numerous array—politics of distribution are affected by considerations that deviate from the traditional standards of domestic socio-economic redistribution and concurrently undermine Member States' capacities to realize these standards. Hence, granted that the EU has grown beyond a community with no distributive relevance, it is hard to argue that redistributive taxation should—due to its exclusive material nature as a mode of public authority—without further qualifications be expelled from the effects of European legislative powers.<sup>71</sup> Rather, the future politics of distribution could be a corrective means by virtue of which the earlier distributive consequences of European integration are compensated and balanced.

Would the European regulation of redistribution also require reinterpretation of the traditional boundaries of communities within which the redistribution through taxation is carried out? More precisely, would it result in the redistribution of resources across the Member States, which would further entail the abandonment of nationally insulated patterns of redistribution? In the context of the EU, discussion on distributive measures is frequently connected to the model of transnational allocation of resources: In the first phase, the EU would receive funding from Member States or extract revenues directly from citizens, and in the second phase, it would distribute the funds between states, regions, or comparable units. Surely, in the course of integration, this sort of strategy has already informed the establishment of several EU funds that have been set up—for instance, to bring about economic cohesion between European regions<sup>72</sup> and integrate people into working life, like the European Social Fund and the European Globalization Adjustment Fund. Through the pooling of resources and their successive distribution from a common purse, the EU has in fact already crossed the nationally constituted boundaries of redistributive communities.<sup>73</sup> In the long run, the focus of overtly redistributive European measures has predominantly been on

<sup>67</sup>Giandomenico Majone, *Europe's Democratic 'Democratic Deficit': The Question of Standards*, 4 EUR. L.J. 5 (1998); Andrew Moravcsik, *In Defence of the 'Democratic Deficit': Reassessing Legitimacy in the European Union*, 40 J. COMMON MARK. STUD. 603 (2002).

<sup>68</sup>Claus Offe & Ulrich K. Preuss, *The Problem of Legitimacy in the European Polity: Is Democratization the Answer?*, in *THE DIVERSITY OF DEMOCRACY: CORPORATISM, SOCIAL ORDER AND POLITICAL CONFLICT* 175, 180 (Colin Crouch & Wolfgang Streeck eds., 2006); Andreas Follesdal & Simon Hix, *Why There is a Democratic Deficit in the EU: A Response to Majone and Moravcsik*, 44 J. COMMON MARK. STUD. 533, 542, 551 (2006).

<sup>69</sup>Jukka Snell, "European Constitutional Settlement," *an Ever-Closer Union, and the Treaty of Lisbon: Democracy or Relevance?*, 33 EUR. L. REV. 619 (2008).

<sup>70</sup>de Witte, *The Architecture*, *supra* note 66, at 13–17.

<sup>71</sup>Agustín José Menéndez, *Taxing Europe: Two Cases for European Power to Tax (with Some Comparative Observations)*, 10 COLUM. J. EUR. L. 297, 314–26 (2004).

<sup>72</sup>See Dermot Hodson, *Regional and Structural Funds*, in *THE OXFORD HANDBOOK OF THE EUROPEAN UNION* 496, 497–99 (Erik Jones, Anand Menon & Stephen Weatherill eds., 2012).

<sup>73</sup>For this development, see Menéndez, *supra* note 71, at 314–26.

regional or international distribution, while redistribution through taxation within Member States has been informed by socio-economic circumstances of individual citizens.

Recapitulating Member States to enforce their distributive standards through taxation differs from pursuing principles for transnational distribution of resources; the former aspires to enhance conditions for socio-economic redistribution within polities, not between them. In this sense, the EU would not only reconcile the interests of states, regions, or nations, but also the preferences of distinguishable socio-economic classes and—accordingly—individuals within countries.<sup>74</sup> By remaining deferential to this reality, one avoids the fallacy of politically consonant countries without internal conflicts of interest—conflicts that are, for instance, showcased by the imbalanced empowerment of migrant capital over labor through economic integration.<sup>75</sup> Contemporary visions of future European politics of taxation indeed take these disparate economic standings into consideration and propose that taxes should be imposed on capital and corporations.<sup>76</sup> While mobile capital and corporations have benefited most from market integration in general, the additional invigoration of their interests in national politics of taxation may be countervailed through market-correcting means. Considering that particularly democracy-enhancing redistribution within polities has been constrained by the asymmetric economic constitution and for the benefit of migrant economic forces, the balancing act of regulating capital and corporate taxes appears a consistent and proportionate response. Consequently, it would not require that the mechanism of redistribution through taxation be extended beyond national communities—which have traditionally asserted the boundaries of redistributive measures. Hence, regulating income taxation and redistribution beyond the state—in a joint exercise of legislative power—would not require pooling and distribution of resources between Member States. The personal scope of domestic redistribution through taxation would not be touched upon.

## II. Representativeness and Procedural Legitimacy

The democracy-enhancing intention constitutes only one facet in the symbiosis between taxation and democracy—the substantive essential. Provided that European governance of taxation would—through redistributive politics of taxation—contribute to the democracy-enhancing function of taxation, would it also foster a democratically representative process of tax law-making—the procedural essential? Or would it—on the contrary—undermine its still existing democratic building blocks? The answer is contingent on the actual institutional design of the EU.

Resembling the era of integration prior to the Single European Act, the requirement of unanimous legislative decision-making still pertains to the enactment of tax laws: No Member State should be subject to a tax statute that it has not agreed to. The rule of unanimity bears particular relevance in the context of legitimacy because—under that very rule—foreign political communities do not overrun national democracies. In that regard, the nationally composed political collective—as an autonomous constituent of democratic power—and domestic institutions—as ultimate loci of democracy—are maintained in operation and shielded against outside constraints, which has been the precise intention behind preserving the unanimity clause in issues of taxation.<sup>77</sup> Consequently, adoption of European tax law derives its procedural legitimacy from

<sup>74</sup>Wolfgang Streeck, *From Market Making to State Building? Reflections on the Political Economy of European Social Policy*, in *EUROPEAN SOCIAL POLICY: BETWEEN FRAGMENTATION AND INTEGRATION* 389, 416 (Stephan Leibfried & Paul Pierson eds., 1995).

<sup>75</sup>See Jussi Jaakkola, *Enhancing Political Representation through the European Economic Constitution? Regressive Politics of Democratic Inclusion*, 15 *EUR. CONST. L. REV.* (forthcoming 2019).

<sup>76</sup>For instance, see Miguel Poyares Maduro, *A New Governance for the European Union and the Euro: Democracy and Justice* (European University Institute, RSCAS Policy Paper No. 11, 2012), at 13–16.

<sup>77</sup>See GENSCHÉL, *supra* note 30, at 18; Menéndez, *supra* note 32, at 81.



Member States—whose extant democratic orders the law would be sourced in.<sup>78</sup> In the case of unanimous decision-making, legitimacy possesses a dualistic structure, where procedural and consequentialist legitimacy spring from two separate sources: Member States with their democratic groundwork provide decisions with procedural legitimacy, while European legitimacy would be dependent on the outcomes of the decision.<sup>79</sup> Because of the rule of unanimity, democratic authority of national constituencies would remain somewhat intact and would not differ from its domestic exercise. Moreover, domestic structures of accountability would persist. Provided that decisions would generate substantively legitimate outcomes that nation-states on their own are not capacitated to achieve, European measures could improve the symbiosis between taxation and democracy without compromising the democratic process as instituted within the national framework. This holds especially true in matters where uncoordinated regulatory competition presents itself as an alternative, which is the case in the context of taxation.

Introducing legislation is only one phase in the existence of law. Its further life consists of amending and repealing it. When a shift in political preference occurs, extant regulatory settlement discloses its deficiencies, or relevant circumstances change, and a need to renounce existing rules transpires. In the context of taxation, amendments and repeals have to be performed in conformity with the rule of unanimity. This constitutes a tangible hindrance to accommodation of once-approved European legislation to the will of electorates, whose boundaries are drawn in national terms. Indeed, the same mechanism of unanimity that initially guaranteed the uncompromised authority of self-contained national democracies transforms into a gargantuan obstacle to the realization of future preferences. Member State democracies become entangled in the prevailing order of norms and entrapped in what Fritz W. Scharpf famously acknowledged and conceptualized as a “joint-decision trap.”<sup>80</sup> Consequently, the European order of taxation would be devoid of flexibility, which has been normatively affirmed as one prerequisite for internationalized fiscal order.<sup>81</sup> If one of the virtues of democracy as an organizational principle for political order is—as Niklas Luhmann suggests—its radical “keeping open of possibilities of future choice,”<sup>82</sup> there would indeed be tension between the legal handcuffs of unanimity and democratic potential. Moreover, as subsequent amendments would necessitate consent by each Member State, the rule of unanimity would not only facilitate the persistence of the existing order but also the dominance by the narrowest possible minority. As a result, the imperative to retain taxation under national control would become a dead letter. From a practical perspective, this ironclad regulatory condition could be alleviated through two regulatory techniques. The first would be temporary legislation, which we are already familiar from the context of indirect taxation, where the standard tax rate was originally set for a fixed duration. The second would be a minimum legislation according to which countries would be entitled to adopt rules that would more robustly enforce the rationale behind European standards.

Considering the shortcomings of the current institutional settlement, would a constitutional revision of decision-making procedures by replacing the unanimity provision with the majoritarian rule make a difference in terms of principle? On the one hand, such a treaty amendment would

<sup>78</sup>See Dieter Grimm, *Auf der Suche nach Akzeptanz: Über Legitimationsdefizite und Legitimationsressourcen der Europäischen Union*, in *EUROPA JA—ABER WELCHES? ZUR VERFASSUNG DER EUROPÄISCHEN DEMOKRATIE* 29, 33–34 (2016).

<sup>79</sup>Erik Oddvar Eriksen & John Erik Fossum, *Reconstituting Democracy in Europe*, in *HOW TO RECONSTITUTE DEMOCRACY IN EUROPE?* 7, 19–22 (Erik Oddvar Eriksen ed., 2007).

<sup>80</sup>Fritz W. Scharpf, *The Joint-Decision Trap: Lessons from German Federalism and European Integration*, 66 *PUB. ADMIN.* 239 (1988); Fritz W. Scharpf, *Legitimacy in the Multi-level European Polity*, in *THE TWILIGHT OF CONSTITUTIONALISM* 89, 100 (Petra Dobner & Martin Loughlin eds., 2010).

<sup>81</sup>Miriam Ronzoni, *Global Tax Governance: The Bullets Internationalists Must Bite—And Those They Must Not*, 1 *MORAL PHIL. & POL.* 37, 43 (2014).

<sup>82</sup>Niklas Luhmann, *The Future of Democracy*, 26 *Thesis Eleven* 46, 46 (1990). Indeed, democracies without a real choice cease to be genuine democracies. See Armin Schäfer & Wolfgang Streeck, *Introduction: Politics in the Age of Austerity*, in *POLITICS IN THE AGE OF AUSTERITY* 1, 1 (Armin Schäfer & Wolfgang Streeck eds., 2015).

erase the possibility of the most severe minority command. On the other hand, it would still require the reinterpretation of the boundaries of the democratic community because national polities would cease to exist as autonomous democratic units and become merged into a wider political body. In the mindscape of a supranational political community, democratic power would be centralized, instead of remaining allocated between what have so far been considered separate and self-governing nations.<sup>83</sup> While redistribution of resources would be preserved within the boundaries of the nation-state, the political power on the basis of which the questions of redistribution are settled would become Europeanized. That this would be something of a novelty can of course be questioned. Indeed, earnest analysis of the transnational externalities that have degraded the national political collectives from self-contained entities and effectively morphed them into an unorganized pack of mutually affected democracies would make the change appear less revolutionary. Furthermore, organized collective decision-making would provide coexistent democracies with representation and voice, which remains absent when political orders remain open in terms of transnational political effects but closed in those of political deliberations and participation. While traditions of representative politics developed in, and were long confined to national contexts, the equation of representation and nation as a political collective should not be asserted dogmatically under the circumstances where national boundaries of political existence have otherwise factually started to disintegrate. Surely, supranational political communities provoke intricate questions about the preconditions of transnationally constituted social and institutional underpinnings of democracy. Nonetheless, income tax regulation, as a somehow exclusive prerogative of the nation-state, should not be excluded but—on the contrary—included in the considerations on reconstructing democratic authority through European politics.

## E. Conclusion

In the context of the nation state, the symbiosis between income taxation and democracy comprises two essentials: (1) The democratic process as a precondition for legitimate taxation; and (2) taxation as a vessel for enhancing democracy through means of redistribution. Furthermore, both essentials acquired legitimacy within nationally constituted polities, as the represented democratic power resided within a national political collective and redistribution was carried out between the members of a national community. As both essentials have been considered to be waning—partly due to the asymmetric integration and the unbalanced European economic constitution—necessity of integrating income taxes at the European level has been proclaimed. With that in mind, the present Article has discussed the substantive and procedural representative legitimacy of future European income tax integration. Surely, the substantive and procedural facets of legitimacy have not been examined, as they would constitute a contradiction between democratic practices and non-democratic functionalist purposiveness. In the case of the last-mentioned contradiction, the decision-making would pursue substantive goals, without giving due consideration to the democratic-representative process. In the context of the present Article, the possible tensions between substantive and procedural legitimacy beyond the state have been analyzed as collisions between two ideals genuinely characterizing the postwar experience of democracy itself.

Although one might argue that both essentials in the symbiosis between taxation and democracy could be more or less restored through legal constraints beyond the nation-state and by transforming the under-governed regulatory void to a law-governed territory, this would not come without a compromise. It would require that the composition of democratic power would not be constructed in compliance with national boundaries and that self-contained national political collectives would be incorporated into a wider aggregate of a shared power structure. Renouncing the nation-based interpretation of a democratic community also urges us to reconsider what is—

<sup>83</sup>For a reflective and recent comment on the prospects and paths of pan-European democracy, see Alexander Somek, *The European Model of Transnational Democracy: A Tribute to Ernst-Wolfgang Böckenförde*, 19 GERMAN L.J. 435 (2018).

and who are—actually represented in political communities. In the early phase of establishing the European market order, undoing the frontiers between the states and national economies was part and parcel of the integration project. Market-building had to reconcile the diverse interests of Member States and—consequently—the political forum where this took place was inhabited by states as interlocutors. As the integration progressed, it was more visible that its results accrued unevenly for the benefit of different economic groups—workers, consumers, financial asset owners, and so on—which can be acknowledged in the terrain of taxation also. This renders it unimaginable to ignore the issues of social justice and fair socio-economic distribution between individuals.

Consequently, instead of perceiving the European endeavor solely as a challenge of reconciling the various preferences of nations or states, it could also be seen as a process of settling the interests of socio-economic classes. In this sense, the European Parliament could be seen as a more proper political body for future European politics of taxation than what it has so far. Of course, the European Parliament with its electoral system is far from an ideal parliamentary entity. Nonetheless, when considering taxation as one of the chief instruments for carrying on distribution within societies, it would be hard to reduce the politics of taxation to controversies between allegedly homogenous national interests. In the end, advancing the European politics of taxation might not only require the reallocation of powers between the EU and its Member States, but also between the decision-making organs of the EU itself.