

**ABSTRACT:**

The issue of What the EU Should Do, or what should be the competences of the European Union, is gaining more relevance with the increasing level of EU integration. The academic analysis on the competences of the EU has so far not fully answered this question. The political science literature has focused on the "democratic deficit" and lack of legitimacy of the EU, assuming that solving these problems would naturally lead to the correct allocation of competences. The economic literature on the contrary focuses on fiscal federalism, analysing which policies can be done more efficiently at the EU level, but ignoring whether it is seen as legitimate to reduce national sovereignty on those policies. This paper argues that only a combination of the two approaches can lead to useful results. It adapts the theory of fiscal federalism to the EU, by incorporating the concept of legitimacy into the analysis. Legitimacy is assessed through three factors proposed by the literature: normative justifiability, popular acceptability and accountability. The analysis is applied to different areas of policymaking. Results show that this modified form of fiscal federalism leads to more complete and realistic insights.