

REFORM OPTIONS FOR THE EU'S SYSTEM OF OWN RESOURCES

Margit Schratzenstaller¹

Austrian Institute of Economic Research

In the negotiations on the EU's budget for 2014 to 2020 member countries almost exclusively focused on individual direct benefits in terms of net financial positions. Indirect benefits from EU membership, EU enlargement and introduction of the euro as well as benefits from EU expenditures other than direct transfers to member states (i.e. expenditures with "European value added", which indirectly benefit all member states and the EU as a whole, e.g. expenditures for research and development, education, green technologies and energy) were neglected. As a result potential indirect benefits from expanding the overall volume of the EU budget volume, to adjust it to the growing challenges the EU is facing, played a minor role in individual countries' views on a desirable EU budget: as did the "European value added" which could be realised by a shift of expenditures away from expenditure categories mainly benefiting individual countries directly (e.g. common agriculture payments) to expenditure categories which indirectly benefit member states and the EU as a whole (e.g. expenditures for research and development, education, or green technologies and energy).

A fundamental reform of EU expenditures towards a sustainable structure requires a fundamental reform of the EU's system of own resources. Only by replacing a substantial part of national contributions by own EU taxes can the narrow focus on financial flows to and from the EU budget be broadened to include also indirect benefits for individual member countries and the EU as a whole. After reviewing the most important deficits of the EU's current system of own resources, the paper establishes criteria for "good" EU taxes and applies these to a number of candidates for EU taxes (e.g. a tax on financial transactions or on carbon dioxide emissions) to assess their suitability as new revenue sources for the EU.

Keywords: EU budget, EU taxes, EU system of own resources, European public goods

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e-mail: margit.schratzenstaller@wifo.ac.at

The EU Treaty foresees an annual budgetary procedure for the EU budget. For several reasons, such as securing budgetary discipline, expenditure control or to support the implementation of longer-term spending priorities, the multi-annual financial framework (MFF), a multi-annual planning process into which annual budgets are embedded, was introduced in 1988. A unanimously adopted Council Regulation after obtaining consent of the European Parliament establishes the financial framework within which annual budgets will be set up. This procedure not only aims at facilitating budgetary planning over the longer term, but also at reining in recurrent political debates on the allocation of expenditure.

The negotiations on the EU's MFF for the period 2014 to 2020 appeared – considering, *inter alia*, the veto threats uttered by several member states at relatively early stages of the negotiation process – to be even more conflict-ridden than those on the preceding four MFFs, which were already increasingly tedious and protracted. Starting point of the negotiations was the European Commission's proposal presented in the end of June, 2011. This draft envisaged for the whole seven-years-period a total volume of commitment appropriations of € 1.025 billion (in constant 2011 prices) or 1.05 percent of EU27-GNI. This proposal was updated in July 2012, primarily to account for the accession of Croatia mid-2013, to € 1,045 billion (1.08 percent of GNI). In relation to GNI, the proposed volume of the MFF 2014-2020 would have fallen short of the preceding one for the period 2007 to 2013, which for the whole period foresaw commitment appropriations of 1.12 percent of GNI.

After several negotiation rounds in the Council of Ministers in the European Union and in the European Council a special EU summit exclusively dedicated to the EU budget, which was scheduled for the end of November 2012, should bring about the desired compromise between the European Council, the European Commission and the European Parliament. This summit, however, was interrupted without results and the negotiations were postponed to another special EU summit scheduled to the beginning of February 2013. This new negotiation round was based an alternative proposal presented by the President of the European Council,

Herman Van Rompuy, immediately before the beginning of the meeting of the European Council in November 2012 which included cutting the original European Commission's Proposal to € 80 billion. In June 2013 finally a compromise acceptable for the European Commission as well as the European Parliament could be reached. It was agreed on a total volume of commitment appropriations of € 960 billion (1.0 percent of EU-GNI) for the next MFF period. Thus, in relation to GNI, the volume of the next MFF is significantly lower than that for the period 2007 to 2013.

Most prominent and debated issues in the negotiations up to now in particular are the overall budget volume, the structure of expenditures, and the continuation of the rebates for (some) net contributor countries. Hereby fundamental need for reform concerning the composition of expenditures as well as the system of rebates is acknowledged in academia and to a large extent also in the EU institutions (European Commission, European Parliament, European Council). At the same time, however, this need for reform is ignored by many representatives of EU member countries in the European Council against the background of their country-specific interests in the concrete negotiations.

In contrast to the reform areas mentioned above, the system of own resources of the EU hardly seems to have been addressed seriously in the negotiations. It is, however, one of the most important obstacles to reform. A fundamental redesign is a central precondition to achieve a negotiation results from which individual member countries as well as the EU as a whole will benefit. In face of weak economic growth and particularly of surging youth unemployment, however, member states' agreement on a future-oriented EU budget would be an important economic impulse as well as an urgently needed signal for European policy's capacity to act to fight the current crisis.

1. The EU's expenditures: challenges and shortcomings²

Without doubt there is an increasing need to support national policies by effective measures on the EU level. The overall EU budget volume at least should be held constant, if not be increased

2. See for this section Schratzenstaller (2013a).

compared to the preceding MFF – in any case, a decrease of total expenditures, as finally agreed on, is inappropriate considering the increasing challenges the EU is facing, in particular, recent and imminent enlargement rounds, structural problems of the Southern peripheral countries, the financial and economic crisis and its consequences (record youth unemployment, debt crisis in some highly indebted member states), and the increasingly pressing long-term challenges (climate change and energy transition, demographic change, increasing income and wealth inequality and risk of poverty). Already the last MFF's 2007-2013 volume fell short of the preceding one. The volume of the available funds thus cannot keep up with the long-term increase of tasks and the corresponding financing needs. In this context the European Commission's top-down approach to keep the EU budget's overall volume below about 1 percent of EU GNI at the outset in their original proposal for the MFF 2014-2020 must be regarded as problematic, as it renders an agreement on a higher overall budget volume highly improbable.

Moreover restructuring expenditures is required to support a more dynamic, inclusive and ecological growth and development path for the EU (socio-ecological transition)³ more effectively than the new MFF does. Within the last MFF 2007-2013, common agricultural policy and structural funds together accounted for almost 80 percent of total expenditures (see Table 1). Common agricultural policy (42 percent of total expenditures) predominantly preserved existing (production) structures and pursuing social goals (income support) within the so-called first pillar. Structural and cohesion policy (36 percent of total expenditures) focused too strongly on a traditional infrastructure policy favouring material (large-scale) infrastructure. Less than 10 percent of the last EU budget was dedicated to competitiveness (i.e. research and innovation) and infrastructure. As "richer" member countries to a substantial extent benefit from subsidies within common agricultural policy and cohesion policy, funds were not redistributed to the "poorer" member states in a focused and targeted way.

3. The analytical foundations of a more dynamic, socially inclusive and ecologically sustainable growth and development path for Europe are elaborated in the WWWforEurope project (www.foreurope.eu).

**Table 1. Expenditure structure – MFF 2007 to 2013 and MFF 2014 to 2020
(Commitment appropriations, in current prices 2011)**

	MFF 2007-2013		European Commission Proposal		Van Rompuy Proposal November 2012		Agreement June 2013	
	In billion €	In %	In billion €	In %	In billion €	In %	In billion €	In %
Competitiveness and Infrastructure	91.5	9.2	164.3	15.7	139.5	14.4	125.6	13.1
Cohesion Policy	354.8	35.7	339	32.4	320.1	32.9	325.1	33.9
Sustainable Growth: Natural Resources (CAP)	420.7	42.3	390	37.3	372.2	38.3	373.2	38.9
Security and Citizenship	12.4	1.2	18.8	1.8	16.7	1.7	15.7	1.6
Global Europe	56.8	5.7	70	6.7	60.7	6.2	58.7	6.1
Administration	56.5	5.7	63.2	6.0	62.6	6.4	61.6	6.4
Compensation	0.9	0.0	0.003	0.0	0.003	0.0	0.003	0.0
Total in € billion	993.6	100.0	1 045.3	100.0	971.9	100.0	960	100.0
Total in % of GNI	1.12	–	1.08	–	1.01	–	1.0	–

Source: Own compilation.

In its original proposal for the MFF 2014 to 2020, which in the updated version from July 2012 foresees commitment appropriations of € 1,045 billion or 1.08 percent of EU-GNI, the European Commission envisaged a slight reduction of the share of common agricultural policy in overall expenditures from about 42 percent in the MFF 2007-2013 to about 37 percent and a slight shift from the first pillar to the potentially more sustainable second pillar (rural development). A slightly shrinking share of total expenditures (32 percent) should be reserved for structural and cohesion funds. Thus common agricultural policy and cohesion policy were planned to still reach about 70 percent of total expenditures. The share of funds explicitly reserved for research and innovation according to this proposal should have remained below 10 percent of total expenditures; total expenditures for competitiveness and infrastructure should be increased to over 14 percent.

The new MFF for 2014 to 2020, which was agreed on in June 2013, dedicates 13 percent of the total sum to competitiveness and infrastructure, 34 percent to cohesion policy and another 39 percent to agricultural policy, which implies only minor shifts in the current composition of expenditures. In contrast, strength-

ening the EU budget's role as an instrument to support socio-ecological transition in the EU, which goes beyond the Europe 2020 strategy and is targeted more intensely on combining economic dynamics with ecological and social goals, requires the following key elements:

- Stronger reduction of the expenditure share of common agricultural policy, reinforcing the shift of agricultural expenditures to a second pillar of common agricultural policy which is based on ecological and employment goals;
- Reinforcement of “greening” of direct payments within the first pillar of common agricultural policy, i.e. linking a significant part of direct payments to the fulfilment of certain ecological conditions by the receiving farmers and cutting direct payments if these conditions are not fulfilled;
- Stronger focus of cohesion funds on “poorer” member countries and corresponding reduction of funds for “richer” member countries (Aiginger *et al.*, 2012);
- Stronger coupling of cohesion funds with climate objectives and employment goals.

Linking cohesion funds with efforts to improve competitiveness and with the indicators applied within the EU's new economic governance (macroeconomic imbalances), to create a link between the Euro crisis and the EU budget (Becker, 2012).

Stronger increase of expenditure share for research and innovation with a specific focus on ecological and social aspects.

2. Alternative revenue sources for the EU

Against the background of this reform debate, which dates back to before the current financial negotiations, some long-term trends of the level and composition of EU revenues and potential inherent problems are of immediate interest. This leads to the question of how to assess the most substantial reform proposal in the current debate, which has been advocated for years notably by the European Commission, namely to attribute own tax revenues to the EU and to finance part of the EU budget through dedicated EU taxes and to review particular taxes in the light to their possible qualification as EU taxes.

2.1. Volume and composition of EU revenues

The EU, lacking tax sovereignty, does not have the right to raise taxes or contributions in order to finance its own tasks. Rather, tax sovereignty within the EU is assigned to the member countries at the national level or in some cases the sub-national level. Some (very small) part of national tax revenues that member states raise for the financing of their own budgets is transferred to the EU. The EU currently has essentially three revenue sources: traditional own resources (agricultural tariffs, sugar customs duties, general tariffs), VAT-based own resources and GNI-based own resources.⁴ EU expenditure must be financed exclusively from own resources, with the option of running a budget deficit being excluded by the EU Treaty.

The financing system of the EU has been changed six times through own resources decisions by the European Council and the European Parliament since 1970. Since then *ad hoc* national contributions by member states were increasingly replaced by a system of own resources and vanished completely in 1982 (European Commission, 2011a). These own resources accrue to the EU directly, without any further decisions required at the national level. Total revenues are limited by a ceiling for EU own resources.

Until 1980, the traditional own resources, which were introduced in 1968, were the only financial source of the EU. They are collected by member states on behalf of the EU and directly transferred to the EU budget (minus a discount of 25 percent remaining with member states to cover the cost of revenue collection⁵). VAT-based own resources were introduced in 1979, originally as a residual financing source with a uniform call rate from a harmonised tax base which is limited to 50 percent of national GNI (capping). At its introduction, the (maximum) call rate was fixed a 1 percent. In 1985 it was raised to 1.4 percent and between 1995 and 1999 reduced in steps to 1 percent again. For 2002 and 2003 it was cut to 0.75 percent and for the years from 2004 to 2006 to 0.5 percent. The MFF 2007 to 2013 provides for a call rate of

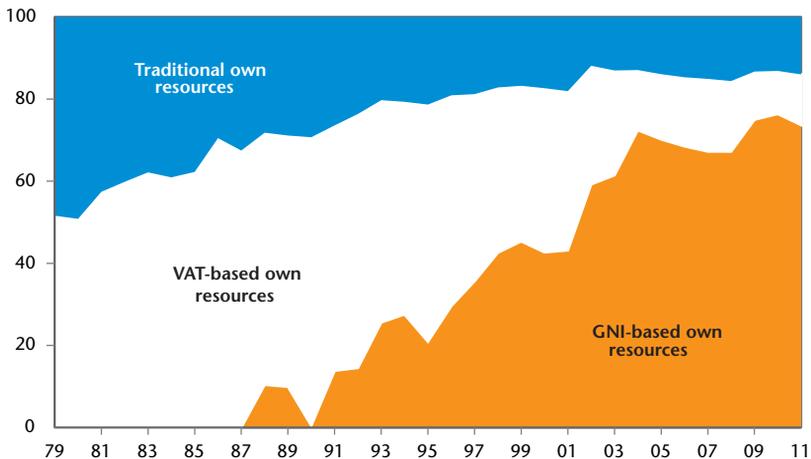
4. This revenue source was originally calculated on the basis of GNP (gross national product), but since 2002 it is determined on the basis of GNI (gross national income).

5. This flat-rate deduction was 10 percent until 2000. One of the European Commission's proposals for reforming the system of own resources is to reduce the rate from its current level of 25 percent to the original level again (European Commission, 2010).

0.3 percent. In the context of financing the “UK rebate”, some net contributors have been granted for the period 2007 to 2013 only a reduction of the call rate (Germany 0.15 percent, Sweden and the Netherlands 0.1 percent, Austria 0.225 percent). The GNI-based own resource exists since 1988. As a residual financing source they serve to balance the budget subject to the own resources ceiling; as a consequence, the call rates (which are identical for all member states) are updated each year. Both the kind and the scope of the generation of own resources as well as the taking over of own tasks by the EU have to be voted by unanimity by the European Council and by all member states according to their respective constitutional provisions. The current EU expenditure ceiling, which is equal to the revenue ceiling, is set at 1.29 percent of aggregate EU GNI (commitment appropriations) and 1.23 percent (payment appropriations), respectively. In practice, this ceiling is never reached. As a rule, actual payments by member states fall markedly below the ceiling: In 2010, for example, they amounted to 0.97 percent of GNI; in the second half of last decade they fluctuated around 0.9 percent of GNI.

Since the end of the 1970s a remarkable structural shift can be observed for the composition of the EU’s own resources (Figure 1).

Figure 1. Composition of EU revenues from own resources



Source: European Commission, 2012.

Traditional own resources received directly by the EU have greatly lost in importance due to the fall of custom revenues in the course of trade liberalisation and EU enlargement: whereas in 1980 they accounted for almost 50 percent of total revenues, their share has since fallen steadily, declining to about 20 percent in the mid-1990s to about 15 percent since 2005. Thus the financing of the EU budget is increasingly resting on direct contributions from member states' national budgets. The share of revenues from the VAT-based own resource reached its peak at 70 percent in 1986 and 1990, to shrink steadily afterwards to 12 percent in 2011. In parallel, the share of revenues from the GNI-based own increased continuously from 10 percent in 1988 to 74 percent in 2011.

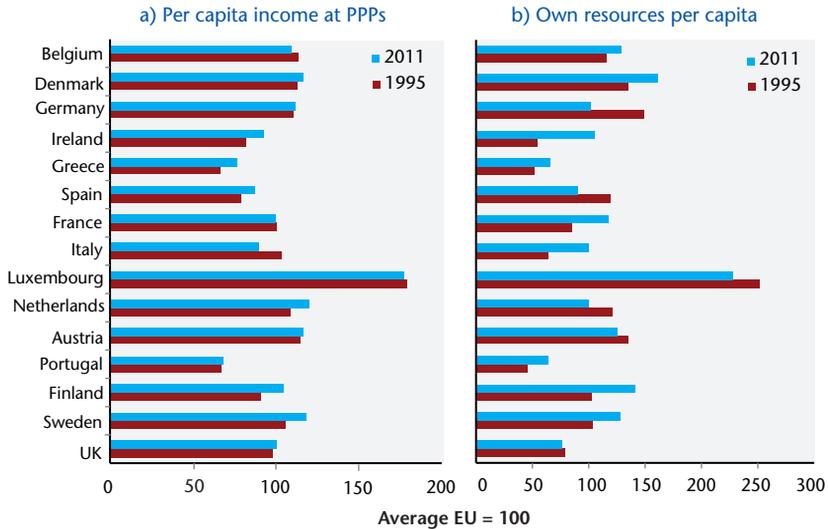
This development is caused by two Council Decisions, from 1992 (effective as of 1995) and 1999 (effective as of 2002), which have shifted the bulk of financing from the VAT-based towards the GNI-based own resource component. Part of this move were the above-mentioned stepwise cuts in the call rate for the VAT-based own resource to meanwhile 0.3 percent of the harmonised VAT base which itself had been reduced to 50 percent of national GNI over the same period. One motive of this move from VAT-towards GNI-based own resources was to widen the financial scope of the EU budget, the easing of the financial burden for the economically weaker member states another: while contributions on the basis of VAT have a tendentially regressive effect, the contributions linked to GNI better reflect a country's economic capacity (Deutsche Bundesbank, 1999).

Whether in this way the economically weaker member states have actually been exonerated cannot be examined and evaluated in detail here. However, the trend of GNI per capita is not necessarily parallel to that of national contributions per capita, as can be illustrated by the example of "old" member states (Figure 2): For 8 old member states, per capita incomes compared to the EU15 average increased (decreased), while their own resources contributions per capita decreased (increased) in 2011 compared to 1995.

Until 2011, the EU budget rose to a total of € 120 billion, compared to € 67.8 billion in 1995. Since 1995, Germany's share in total own resources fell from 31.4 percent to about 20 percent, partly because the country's share in aggregate EU GNI declined, but partly also due to a reduction of the contribution burden

through various correction mechanisms (see below). Also the contribution by France and the UK to total own resources payments have slightly fallen during the last 15 years. At the same time, the share of “poorer” countries as Spain, Italy and Portugal has (slightly) risen.

Figure 2. GNI and national contributions of EU member states, per capita



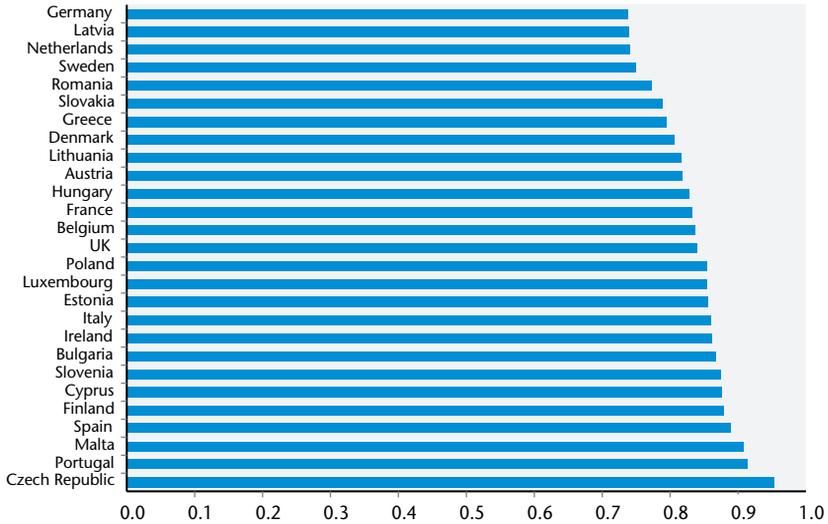
Sources: European Commission (2012), own calculations.

The gross contribution, i.e. total payments made to the EU, is the most straightforward measure of a country’s contribution to the financing of the EU budget. Deducting traditional own resources delivers the national contribution, consisting of VAT- and GNI-based own resources. The national contribution (Figure 3) is more appropriate than the gross contribution for comparisons between member states, since it reflects the resources actually raised by individual member states. Figure 3 shows national contributions as percent of GNI (including the UK rebate) for 2011. The national contribution is lowest in Germany, with 0.74 percent of GNI, and highest in the Czech Republic (0.95 percent of GNI) in 2011.

In the political debate and in EU budget negotiations, the net contribution position, as recorded in the national balance of payment statistics, plays a more important role than the national contribution. As the balance of financial transfers (VAT- and GNI-

based own resources) paid to the EU and transfers received from the EU budget, it expresses a member state's financial net benefit or cost from the EU budget.

Figure 3. VAT- and GNI-based own resources (national contributions) of EU member states in 2011, as percent of GNI



Source: European Commission, 2012.

Apart from the fact that the net contribution position alone cannot by far capture the entire economic impact of European integration upon member states – beyond direct transfers from the EU budget, EU membership carries a number of indirect economic effects, such as potential access to new markets –, the calculation of this indicator is subject to a certain margin of uncertainty.⁶

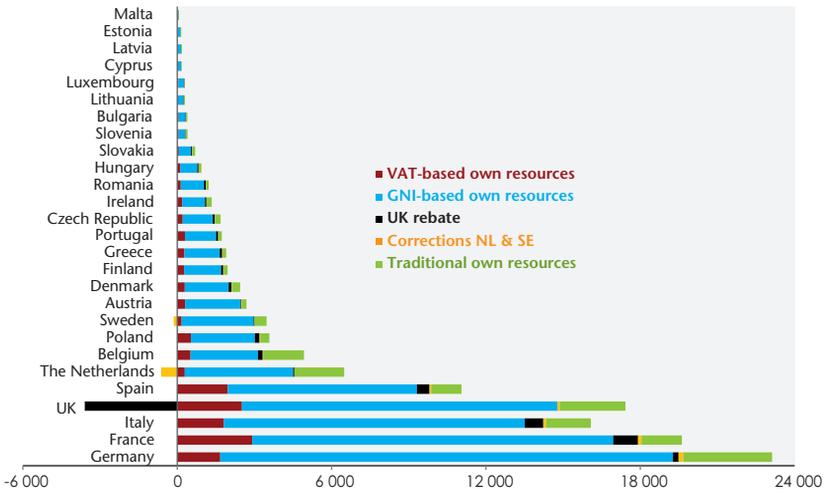
Since its introduction, the “UK rebate” has been a topical issue in the context of the net contribution position. In 2011, the rebate amounted to € 3.6 billion. Following a decision of the European Council of Fontainebleau in 1984, the UK is reimbursed two thirds of its annual net contribution. The special provision was successfully negotiated by former Prime Minister Margaret Thatcher at a time when the UK had a relatively low per capita income within the EU. Due to its comparatively small agricultural sector, the

6. See Clemens and Lemmer (2006) for details.

country received considerably less in EU agricultural payments than, for example, France. The adjustment in favour of the UK is financed by the other member states according to their levels of GNI. Since 2001, a special clause applies for the traditionally most important net contributor countries Germany, Austria, Sweden and the Netherlands, which pay only 25 percent of their normal financing share of the UK rebate (Clemens and Lemmer, 2006).

The impact of the UK rebate on the distribution of own resource payments in absolute terms is shown in Figure 4. The rebate moves the UK down from the second to the fourth largest contributor.

Figure 4. Own resources payments to the EU in 2011, in billion €



Source: European Commission, 2012, own calculations

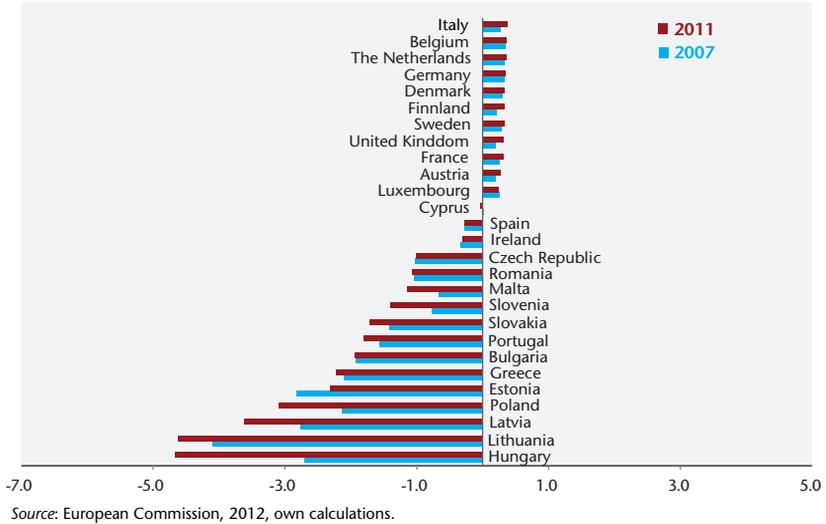
In relative terms, the UK’s national contribution of 0.84 percent of GNI is on rank 14 (see Figure 3). The termination or at least reduction of the UK rebate which has been claimed for some time by almost all other member states is subject to the UK’s consent which is unlikely to be obtained without a far-reaching overhaul of EU common agricultural policy.

In 2011 as well as during the period 2007 to 2011, 11 of the 27 member states were net contributors.⁷ In the period 2007 to

7. Cyprus net position amounted to practically zero, with a net contribution of 0.02 percent of GNI in the period 2007 to 2011 and of -0.04 percent of GDP in 2011.

2011, the largest net contributors in relation to their GNI are Germany, Belgium, the Netherlands and Denmark (Figure 5).

Figure 5. Net contributions by member states, as percent of GNI



2.2. Problems and need for reform in the current system of own resources

The financing system of the EU in the design which has evolved over more than 60 years since the foundation of the European Coal and Steel Community (ECSC) in 1952 is characterised by a number of shortcomings rooted in the low and still decreasing revenue autonomy of the EU. While the correction of these shortcomings has been on the political agenda for some time, the required unanimity vote in financial matters has so far stood in the way of a fundamental reform. However, the growing resistance notably on the part of net contributors, which makes negotiations on the MFF and also on the yearly budgets increasingly tedious, adds to the pressure to seek alternatives to the existing system of own resources. This section briefly presents the most important problematic aspects and effects of the current system of own resources.⁸

8. While their presentation is structured somewhat differently, the aspects elaborated in this section are mainly those addressed in European Commission (2011a) and several related academic studies cited there.

2.2.1. Increasing controversiality of size and structure of EU budget

Since the EU can neither raise its own taxes nor (according to Article 311 of the Treaty on the Functioning of the European Union) incur debt, its revenue autonomy has been curtailed from the outset. Meanwhile, it has become negligible since the traditional own resources have greatly lost in importance. As presented in more detail above, now the own resources of the EU consist primarily of member states' contributions paid directly from national budgets. Thus the EU budget has increasingly become the subject of political conflict, as most clearly revealed by the "net contributor debate". Reaching an agreement on the MFF is becoming more and more difficult, particularly with economic divergences widening in the last (and future) enlargement rounds. This carries the risk of the EU budget becoming chronically under-financed against the challenges facing the EU in the future. Such risk is witnessed by the current MFF 2007 to 2013 as well as by the proposal for the next MFF 2014 to 2020, each setting expenditures to decline as a ratio of EU GNI, rather than being at least held constant as warranted by the current and future tasks of the EU.

2.2.2. Increasing neglect of "European value added" and dominance of national interests

The predominance of national contributions narrows down the focus of member states on monetary net returns from the EU budget, i.e. the relation between national contributions to the budget and monetary returns from the individual policy areas (common agricultural policy, structural and cohesion policy, research and innovation, etc.) (European Commission, 2011a; Becker, 2012). Benefits of EU membership beyond pure financial flows related to the EU budget, however, do not play much of a role as evaluation and decision criteria of member states (Richter, 2013). Within the EU with its increasing divergences and therefore national interests, such a perspective focusing on individual country-specific monetary costs and benefits inevitably aggravates the EU budget's controversiality and increasingly hinders compromises. It is an essential reason that particularly net contributor countries, whose gross contributions exceed transfers received from the EU budget, urge a limitation of the EU budget's volume. Moreover it furthers the tendency of member states to support the

preservation of those expenditure categories promising to maximise individual country-specific transfers received from the EU budget, instead of pushing an expenditure structure from which a maximal benefit for the EU as a whole (what the European Commission calls “European value added”, see European Commission, 2011c), may be expected. The focus on individual national interests is also enforced by the increasing public attention for questions of EU policy (Becker, 2012). The distributional conflicts as well as the “net contributor debate” more recently have been aggravated by the (potential) burden from the EU rescue package the largest part of which falls upon Eurozone countries.

In this context it should be recalled that the financial resources at the disposal of the EU also serve to finance various “European public goods”, i.e. goods or activities with positive cross-border external effects⁹ and with European value added (European Commission, 2011c), respectively. In particular this concerns expenditures in the areas of research and innovation, education, transport infrastructure, and climate/energy policy, decided upon at the EU level. Securing fiscal equivalence (i.e. a correspondence of revenue and expenditure responsibility) would require assigning to the EU also the taxes necessary to finance these expenditures.

2.2.3. No contribution by the system of own resources to EU policies

Moreover, the lack of tax autonomy at the EU level runs counter to the long-term trend of deeper integration. Despite an increase in negative cross-border externalities (e.g. environmental damage) caused by ever closer economic integration of member states, policy refrains from using taxes at the European level to influence economic agents' behaviour. Thus potential benefits of a rather powerful market-based policy instrument are foregone. In general, the current revenue system hardly contributes or supports EU policies (European Commission, 2011a).

2.2.4. Increasing complexity of the system of own resources and political legitimacy

In addition, the system of own resources is characterised by a considerable degree of complexity and lack of transparency. While

9. Consider in this context also the evolving debate about “global public goods” (see, e.g., Kaul *et al.*, 1999).

the three revenue sources as such are easy to understand, their implementation is not. This is mainly caused by the UK rebate and the various mechanisms for its correction. In addition, the concrete design of the VAT-based own resource, particularly the determination of the tax base, is often criticised as rather complicated.

Moreover, the structural adjustments made since the early days of the European Community are the result of political compromises (such as the correction mechanism for the financing of the “UK rebate”). Apart from the resulting administrative burden, this trend also undermines political credibility and the legitimacy for national financial contributions, since the population of the individual member states is less and less able to identify its own contribution to the financing of the EU budget and the relationship between revenue and expenditure.

2.2.5. Equity concerns

Not least, within the group of net contributing countries which in the period from 2007 to 2011 included 11 member states, a “rebate from the rebate” for the UK was granted to the 4 countries which traditionally are the most important net contributors only, despite the fact that these are not necessarily – in relative terms – carrying the largest net contribution burdens (see Figure 5). Therefore the complete elimination of the correction mechanism for the UK rebate is an important element of a more simple, transparent and equitable system of financing the EU budget: The more, as the initial reason to grant a rebate to the UK in the first place – relatively low economic prosperity and high net contributions – has disappeared during the last 30 years (Economic Commission, 2011a).

From an equity perspective it may also be considered problematic that the poorer member states which are on the one hand benefiting from cohesion policy over-proportionately contribute to financing the various correction mechanism to alleviate the net contribution burden of the richer countries on the other hand (European Commission, 2011a). It may also be criticised that capping individual VAT-based resource payments by limiting the part of the harmonised VAT base on which the call rate is applied to 50 percent of GNI does not necessarily alleviate the burden for the poorer countries, as there is no clear relationship between a country’s GNI and the size of the VAT base.

2.3. Options for a fundamental reform of the system of own resources of the EU

2.3.1. Current state of the political discussion

The MFF 2007 to 2013 has not brought about any fundamental changes for the system of own resources. The own resources ceiling was confirmed to 1.24 percent of GNI (for payment appropriations) and 1.31 percent of GNI (for commitment appropriations), respectively. Also the “UK rebate” was maintained, as well as the correction mechanisms for its financing in favour of Germany, Austria, Sweden and the Netherlands (“rebate from the rebate”). The UK therefore in principle continues to benefit from its rebate. The call rate for the VAT-based own resource was generally reduced from 0.5 to 0.3 percent, with several net contributors benefiting from a lower rate in the period 2007 to 2013 only (Austria 0.225 percent, Germany 0.15 percent, the Netherlands and Sweden 0.10 percent). In addition, Sweden and the Netherlands may reduce their GNI-based annual gross contributions by € 150 million and € 605 million (in constant 2004 prices), respectively in the period from 2007 to 2013 only.

In December 2005, the European Commission has been invited by the European Council to undertake a revision of the EU budget in the form of a “mid-term review”, which should also include a review of the system of own resources, and to report to the European Council by 2008/09. This review should feed into the preparations for the next MFF. In this way, the need for reform of the EU financing system, generally felt across member states and the European institutions, has been taken up, without however an actual announcement or commitment to such reform being given. The European Commission’s publication of its Communication on the EU Budget Review (European Commission, 2010) as one core principle of the EU budget puts forward a reformed financing system. According to the European Commission, new own resources could substitute the VAT-based own resource and a part of the GNI-based resource.

In its proposal for the own resources decision (part of the whole package related to the MFF) the European Commission (2011b and 2011d) suggests three elements of the reform of the current system of own resources: firstly the simplification of member states’

contributions by eliminating the VAT-based own resource, compensated secondly by the introduction of new own resources (preferably a financial transaction tax and a new VAT resource), and thirdly the reform of correction mechanisms by implementing a new system of lump sums to replace all pre-existing correction mechanisms.

The European Parliament, which according to the Lisbon Treaty for the first time has a right to co-decision on the MFF and which only after lengthy negotiations only agreed to the new MFF 2014-2020 has been demanding for some time now a reform of the system of own resources which includes the reform of the existing VAT-based own resource and the introduction of an EU tax, i.e. a genuine own resource (particularly a financial transaction tax). Up to now, however, the European Council refuses to negotiate about a reform of the system of own resources and about the introduction of an EU tax in particular.

In the longer-term perspective, budgetary leeway is to be created for the financing of tasks ranking high in the Europe 2020 strategy through further shifts in the expenditure structure, notably the already initiated restraint on agricultural spending. Given the conflicting interests of member states it is nevertheless doubtful whether such shifts will progress at sufficient speed in order to create the necessary budgetary room for manoeuvre. All the more so, since agricultural spending will (have to) remain a major responsibility for the EU, albeit with substantial adjustments towards organic farming, preservation and development of rural areas and promotion of tourism, reflecting the changing role of agriculture. Against this background, conferring a certain degree of tax autonomy upon the EU appears to be an option worth exploring, by substituting own EU tax revenues for part of national financial contributions which face growing resistance, particularly with net contributors.

2.3.2. Key elements of a reform of the system of own resources

Starting from the above criticism of the EU system of own resources, reform options have been considered for some time at the EU level. Following up on agreements reached in the context of the last few financial frameworks, the European Commission in the meantime has submitted several reports on the functioning of

the system of own resources (European Commission, 1998 and 2004); the most recent one in 2011 (European Commission, 2011a). These documents also discuss the pros and cons of various financing alternatives. In principle, two alternative reform strategies to address the existing shortcomings of the system of own resources may be envisaged (European Commission, 2004):

- Reforms within the existing system of own resources with the aim of streamlining it (in practice, this would lead to the elimination of the VAT-based own resource so that, given the ongoing loss in importance of traditional own resources, the budget would in the long run be financed almost entirely by GNI-based own resources);
- Introduction of dedicated EU taxes, as a (partial) compensation for the existing revenue sources. This option, favoured by the European Commission, would assign some degree of tax autonomy to the EU.

The criticism advanced against the current system of own resources advises in favour of the latter reform strategy conferring to the EU some degree of tax autonomy in combination with a reform of key features of the existing system of own resources along the following lines:¹⁰

- Elimination of VAT-based own resources;
- Attribution of dedicated taxes to the EU to compensate for the abolition of VAT-based own resources and in recognition of the arguments in favour of EU tax autonomy;
- Reinforcement of own EU tax revenues through GNI-based own resources;
- Reform of the correction mechanism to finance the UK rebate.

2.3.3. Evaluation of potential EU taxes as a central pillar of a fundamental reform of the system of own resources

Starting from these key elements, the following considerations are devoted to a crucial aspect in the debate on alternative revenue sources for the EU budget, i.e. the question what kind of taxes

10. These key features are also mentioned by the European Commission who nevertheless pleads in favour of the revenue-neutral introduction of a new own revenue source which should cover up to 50 percent of total expenditure (European Commission, 2004).

would lend themselves for the establishment of an own EU tax sovereignty (or as a supplementary or alternative revenue source) (see also Richter, 2006).

One basic assumption is that financing the EU budget entirely or at least primarily through own taxes is for the time being neither meaningful nor possible under the existing framework conditions. One argument against is the existing ban on incurring debt, which requires an additional revenue source to balance the budget in case actual tax revenues fall short of projections. In addition, financing all EU responsibilities entirely by own taxes would require much deeper integration of the EU member states than is presently the case, leading more towards a federal state.

Weighing up between dedicated EU taxes on the one hand and GNI-based own resources on the other hand is an issue beyond pure economic reasoning: It is rather a political decision of member states to what extent they see the Community eventually moving towards a federal state that in the end needs its own legal framework for fiscal relations and an own tax sovereignty. This is also a crucial factor for the degree and factual implementation of the tax autonomy conferred to the EU.¹¹ It may either be confined to the power to decide on how to allocate its own resources, or it may extend to legislative powers in tax matters. In the first case, the EU would receive a certain fraction of national tax revenues or be granted the right to levy a supplementary rate on a given tax base, with the right of decision on tax bases and national tax rates essentially remaining with the member states. In the second case the EU would acquire the right to determine tax base and rate, with member states possibly having the right to levy a supplement.

In its reports on the operation of the EU own resources system, the European Commission establishes seven criteria for the evaluation of own resources (European Commission, 2004):

- visibility and simplicity;
- financial autonomy;
- contribution towards an efficient allocation of economic resources;
- yield;

11. For elaboration of this point, see Becker (2005).

- cost efficiency with regard to tax administration;
- revenue stability;
- equitable gross burden.

These criteria may be applied only partially or in modified form for the following assessment of the suitability of different taxes as financial sources for the EU budget. They will be supplemented by further criteria developed by the theory of fiscal federalism as a yardstick for assigning different taxes to the different levels of government (see, e.g., Musgrave, 1983; Gordon, 1983; Inman and Rubinfeld, 1996; McLure, 2001). Thus, for the assessment of whether a certain tax may qualify as EU tax, the following criteria may be formulated (see also European Commission, 1998 and 2004):

- Degree of regional attribution: the lower the possibility to determine the share of individual member states in the tax base/tax revenues, or the lower the identity between the country where tax revenues accrue and the country of residence of tax subjects, the higher the suitability as EU tax.
- Cross-border negative externalities: the higher they are, the higher the qualification as EU tax, since the optimal tax rate from the national perspective is below the one from the European perspective.
- Mobility of the tax base: the higher it is, the higher in principle the qualification as EU tax, since centralisation may help to prevent a possibly harmful “race to the bottom”.
- Short-term volatility: the higher it is, the lower the qualification as EU tax; due to the ban on EU debt, the flow of own resources should be stable in the short term and as cyclically-insensitive as possible.
- Long-term yield (revenue elasticity): the higher it is, the higher the qualification as EU tax, since with European integration and given the long-term challenges the EU is facing progressing the range of tasks and therefore the financial needs will probably rise.
- Visibility: the more visible and perceptible a tax for the tax subjects, the higher its qualification as EU tax, since the link between tax payment and return from the EU budget is made transparent.

- Equity of gross burden at the national level: the closer the link between the tax base (and therefore the tax burden) and national income, the higher the qualification as EU tax.

The report on the functioning of the system of own resources by the European Commission of 1998 discusses eight kinds of potential own resources: CO2 or energy tax; modified value added tax; excises on tobacco, alcohol and mineral oil; corporate tax; tax on transport and telecommunication services; income tax; interest income tax; and a tax on the ECB gains from seigniorage (European Commission, 1998). The European Commission's report of 2004 limits itself to three options, namely the combination of GNI-based own resources with revenues from energy tax, value added tax or corporate tax. In its latest report on the operation of the system of own resources (European Commission, 2010), the European Commission mentions taxes on the financial sector (financial transaction tax and financial activity tax, revenues from auctioning under the greenhouse gas Emissions Trading System, a charge related to air transport, an EU VAT, an EU energy tax and an EU corporate income tax) as potential candidates for new own resources; where the preferred options put forward in further documents and statements related to the MFF package are the financial transaction tax and an EU VAT. Table 2 gives an overview of the candidates for new own resources mentioned in the European Commission's various reports on the functioning of the system of own resources and options for its reform.

Table 2. Candidates for new own resources according to the European Commission

European Commission 1998	European Commission 2004	European Commission 2010
CO2 or energy tax modified value added tax excises on tobacco, alcohol and mineral oil EU corporate income tax tax on transport and telecommunication services income tax; interest income tax tax on ECB gains from seigniorage	EU energy tax EU value added tax EU corporate income tax	taxes on the financial sector (financial transaction tax and financial activity tax) revenues from auctioning under the greenhouse gas Emissions Trading System charge related to air transport EU VAT EU energy tax EU corporate income tax

Source: Own compilation.

Table 3 contains key features and potential revenues of the candidates (except revenues from auctioning under the greenhouse gas Emissions Trading System) included in the European Commission's latest documents on the operation of the system of own resources and options for its reform. Altogether the potential revenues of the various candidates may contribute to a considerable extent to financing the EU budget.

Table 3. Potential EU taxes

Tax base (tax)	Key features	Potential revenues per year	In % of EU expenditures per year ¹
Financial transactions (Financial Transaction Tax – FTT)	0.1% tax rate on transactions of bonds and shares, 0.01% tax rate on transactions of derivatives,	€ 20 billion (by 2020)	15
	0.1% tax rate on transactions of bonds, shares and foreign currency, 0.01% tax rate on transactions of derivatives	€ 50 billion (by 2020)	36
Sum of profit and remuneration of financial institutions (Financial Activities Tax – FAT)	5% tax rate on sum of profit and remuneration of financial institutions according to the addition-method FAT applied at source, no fully harmonized tax centrally collected at EU level, but revenue-sharing between member states and EU	€ 24.6 billion (2009)	18
Charge related to air transport (Departure Tax or Flight Duty Tax)	Tax on passengers flying from an EU airport, differentiated according to distance and class of travel (Departure Tax), tax on flights (Flight Duty Tax) decentralized or centralized collection possible	€ 20 billion (by 2020)	15
Consumption (EU Value Added Tax – VAT)	1% tax rate on goods and services subject to standard tax rate, decentralized collection and transfer to EU	€ 20.9 billion to € 50.4 billion (2009)	15
Energy consumption CO2 emissions (EU Energy Levy, EU CO2 Levy)	Single EU tax rate on quantities of energy products released for consumption based on their energy content. Minimum rate of CO2-related taxation defined in revised ETD. Decentralized or centralized collection possible	No estimates available	–
Profits of incorporated firms (EU Corporate Income Tax – CIT)	Less than 2% tax rate on national corporate income tax base decentralized collection and transfer to EU.	€ 15 billion	11

1. Expenditures per year calculated as average of total expenditures for the period 2014 to 2020.

Sources: European Commission (2010, 2011a, 2011b); Own compilation.

Most revenue could be created by introducing a **general Financial Transaction Tax (FTT)** of 0.1 percent on transactions of bonds, shares and currency and of 0.01 percent on transactions of derivatives. According to a conservative estimate by the European Commission, the potential yield may reach about € 50 billion per year by 2020, which would cover about one third of the EU's annual expenditures according to the European Council's agreement of February 2013. In a version exempting currency transactions the FTT would still raise about € 20 billion or 15 percent of the EU's expenditures.

A **Financial Activities Tax (FAT)** of 5 percent on the sum of profits and remuneration of financial institutions, as an alternative tax on the financial sector, is expected to yield about € 25 billion per year and could thus finance about 18 percent of the EU's expenditures.

Revenues from charges related to air transport (a **Departure Tax** or **Flight Duty Tax**) and from an EU **Value Added Tax (VAT)** of 1 percent on the goods and services subject to the standard tax rate are estimated to reach a similar size, with about € 20 billion per year (15 percent of the EU's expenditures).

An EU **corporate income tax (CIT)** of less than 2 percent on the national corporate income tax base may yield about € 15 billion (11 percent of the EU's expenditures).

The evaluation of these taxes according to the criteria specified above (Table 4) gives only rough indications since it does not allow for a possible fine-tuning of the different criteria, but only distinguishes between "rather useful" or "rather less useful" as EU tax. For further considerations on the actual design of an own resources system which is based also on EU taxes as genuine own resources, the analysis of course needs to be refined. It would also have to consider administrative costs and the question at which level (national level or EU level) revenues would be collected. None of the taxes briefly discussed below is deemed an "optimal" EU tax, since all of them miss one or more of the criteria defined above. Which of the taxes will actually be selected along these criteria, and the weight to be attributed to each of them, is a political decision in the end.

According to the above criteria, charges on air transport would qualify best as EU taxes. They may internalise negative cross-border externalities (in this case climate-damaging emissions) and thereby reduce air traffic. Assigning these taxes to the EU would rein in the possibility of tax avoidance caused by tax rate differentials between member states. Their visibility for citizens as well as short- and long-term revenue stability and tax yield are further arguments in favour of assigning them to the EU level. In particular the tax avoidance to be expected speaks in favour of earmarking charges related to air transport entirely for the EU: a uniform tax rate should be fixed at the level of the EU and all revenues be channelled into the EU budget.

Table 4. Evaluation of options for EU taxes

	Regional attribution	Negative cross-border externalities	Mobility of tax base	Short-term volatility	Long-term yield (revenue elasticity)	Visibility	Equity of gross burden at national level
Financial Transaction Tax	+	+	+	-	+	-	-
Financial Activities Tax	+	+	+	-	+	-	-
Departure/Flight Duty Tax	-	+	+	+	+	+	-
Value Added Tax	-	-	-	-	+	+	?
Energy Levy/CO2 Levy	-	+	-	+	+	+	?
Corporate Income Tax	+	-	+	-	+	-	-

+ speaks rather in favour of being used as an EU tax. ... - speaks rather against being used as an EU tax.
 Source: Own.

Main arguments in favour of an FTT to be assigned to the EU are the impossibility of a regional attribution of such a tax and its prospective long-term yield. Moreover, unilateral implementation would be next to impossible, and considering the far-reaching integration of the European financial market, the FTT may also internalize negative cross-border externalities. In contrast to an EU CIT or VAT, differing national tax bases would not be an issue. Unfortunately, the current negotiations at the EU level about the introduction of an FTT do not make much progress: Apart from the fact that only 11 EU member states are willing at all – in principle –

to implement an FTT, several of these countries under the pressure of the financial lobbies are pushing very strongly for a very minimalistic (“light”) version of an FTT.

In favour of a partially centralised CIT may be argued that the growing disconnection between value added and corporate location on the one hand, and profit and its taxation on the other, undermines the possibility of regional attribution of the tax. Moreover, it can be expected that corporate tax competition in the EU will intensify further due to the high mobility of the tax base. The CIT is also characterised by a high yield in the longer term.

Taxes on energy consumption have the advantage of low short-term volatility and a high long-term elasticity. Moreover they can internalize cross-border externalities and are highly visible to citizens. It may be objected, however, that the use of the CO₂ tax is problematic because there is no link between the desirable growth of the EU budget and the desirable growth of ecological taxation.

The VAT appears as least suitable candidate. Only its long-term revenue elasticity and high visibility for citizens speak in its favour.

Altogether the most straightforward option for an own EU tax is the FTT which as a new tax has the additional advantage that national revenues would not be affected, which would be the case for charges on air transport and energy taxes which exist at least in some member states already. Thus it can be expected that choosing the FTT as EU tax will meet with less political resistance than options which imply redirecting national revenues to the EU budget.

From an administrative point of view, the FTT has the further advantage that (in contrast to the VAT or the CIT) there are no nationally differing tax bases that would need to be harmonised beforehand. It could cover a substantial share of total EU expenditures. If the aim is to extend the contribution of EU taxes even further, charges related to air transport would be another readily available solution, considering also that only few member states levy such charges at all and that they are exposed to permanent criticism as they are regarded as severe competitive disadvantage when implemented unilaterally at the national level.¹² The same holds for a CO₂ tax which some member states have introduced rather recently.

When designing a new financial framework for the EU resting on a certain degree of tax autonomy, including institutional aspects and political decision-making processes, a number of caveats need to be considered that are often emphasised by the opponents of EU taxes. A major concern is that an own tax responsibility of the EU would lead to permanent upward pressure on expenditure, all the more so as the EU budget is dominated by the goal of redistribution. Moreover, the assignment of (a certain degree of) tax autonomy to the EU would require to reinforce democratic legitimacy, i.e., to strengthen the powers of the European Parliament further as well as to tighten expenditure control and fight against fraud. It can also be expected that the process of unwinding the UK rebate system will cause considerable political controversy. Therefore, any major reform is likely to require a considerable lead time. In this context the problematic role of the unanimity rule as a major barrier for far-reaching reforms needs to be emphasised. It is one of the main reasons that member states prefer to agree on a minimum consensus and for their principally critical attitude towards ambitious reform proposals (Becker, 2012): By restricting themselves to incremental changes member states avoid the risk not to reach a final agreement.

3. Conclusions

There are many good reasons to substitute a substantial share of the existing own resources financing the EU budget by own EU taxes. Most remarkably, many proponents of a fundamental future-oriented reform of expenditure structures of the EU budget, which form the overwhelming majority among experts and politicians as well up to now appear to fail to realise that the current system of own resources is one – if not THE – most influential cause for the existing shortcomings of the expenditure side of the EU budget. Until now attempts to secure an expenditure size and structure which may more effectively than today support the EU's policy priorities as laid down in the Europe 2020 strategy and beyond has failed primarily because the influence of the design of the revenue system is widely underrated. However, without a

12. Austria therefore has just reduced the rates of its flight charge which was introduced in 2011 as part of the fiscal consolidation efforts.

reform of the system of own resources a volume and structure of EU expenditures adequate to cope with the current problems and future economic and societal challenges the EU is facing appears as improbable as the radical elimination of the existing system of rebates. Not the least advantage of those EU taxes which help to internalize negative externalities is that they would allow reducing national contributions financed by more distorting taxes levied by member states. Thus the introduction of such EU taxes may contribute to current efforts to improve the structures of national tax systems.

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