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ANALYSIS

The EU's Resources: Change or Status Quo?

With the Council of Ministers recent adoption of the decision setting the European Union's 2007-2013[1] financing system, it seems all the more useful to analyse the prospects for this system's evolution that it will be at the heart of the coming revision of the 'European financial framework'[2].

Like the level and structure of community expenditures, the question of how the EU is to be financed indeed continues to give rise to much debate and uncertainty. To shed light on these issues as well as clearly identify the questions around which decisions[3] relating to community budget financing have crystallized and on which the revision exercise set to begin in Autumn 2007 is most likely to focus, the evolution of EU financing must be put into historical and political perspective.

Historically, the obligation to assure adequate financing for community expenditures and the need to fairly distribute financing costs between Member States appear to have been the main issues at stake in European negotiations and seem to have been handled on quite a consensual basis. In recent years, arguments in favour of greater transparency in community financing, increased incentives for economic actors and greater autonomy for the EU have gradually assumed importance. For the moment, they have failed to result in notable change and it is not impossible that the coming revision will confirm this status quo.

What is considered to be efficient financing of community expenditure has been in place since 1988

The need to efficiently assure coverage for community expenditures constituted the foremost determining element in the evolution of the European Community financing system. Between 1970 and 1988, this led to several modifications in the structure of community resources. Since then, a relative status quo has reigned.

The structure of community resources has been the object of several modifications

• While EU financing initially reposed on contributions paid by the six Member States of the European Community, an 'own resources system[4]' was established in 1970 and based on:

- What are known as 'traditional' own resources (TOR) drawn from profits on community customs duties, deductions on agricultural imports and a tax on sugar production;
- A national contribution based on the collection of a percentage of Member States' VAT base rate (known as the 'VAT resource') to be mobilised when profits from the TOR do not cover anticipated community expenditures[5].

• Growth in community spending (particularly structural expenditures) then led to an increase in the rate of call of the 'VAT resource' from 1% to 1.4% (the 'own resources' decision of 1985).

• The 'own resources' decision of 1988 finally led to the creation of a national contribution based on the gross national product of member countries (initially known as the 'GNP resource' and more recently as the 'GNR') : it is now up to this resource (and no longer the 'VAT resource') to assure the balance of the community budget and its importance has been reinforced with growth in community spending (see Table 1).

Debate over the level of resources is directly tied to that over the level of community spending

• The stability of the EU's financing structure since 1988 is largely explained by the fact that increased spending has since that date been managed via the creation of a 'global own resources ceiling' determined by the European Council. Initially set at 1.20% of the EC's GNP between 1988 and 1995, this ceiling evolved from 1.21% to 1.27% between 1995 and 1999 and has since been several times confirmed, most recently in 2005[6].

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[1] See: http://eur-lex.europa.eu/LexUriServ/site/fr/oj/2007/l_163/l_16320070623fr00170021.pdf The 27 national parliaments of the EU must ratify it for it to go into force; its effect will be retroactive to January 1st, 2007.

[2] The European Council of December 2005 invited the European Commission to 'undertake a complete and global re-examination' of all aspects of EU resources and expenditures.

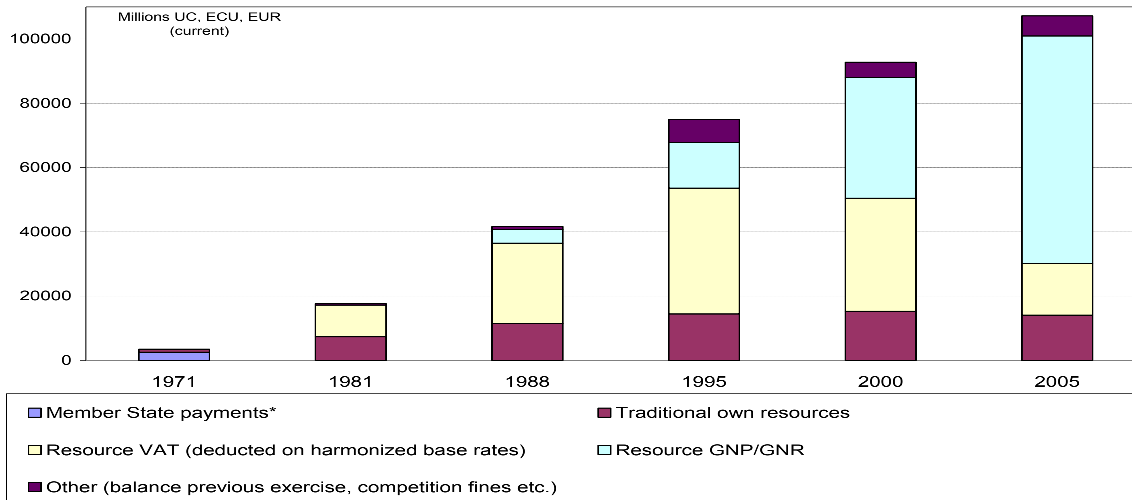
[3] The five preceding 'own resource' decisions date from 1970, 1985, 1988, 1994 and 2000.

[4] Own resources can be defined as the final payments made to the EU as a matter of right and without prior decision by national authorities.

[5] This resource was only established in 1980 following an initial community harmonisation of the VAT base.

[6] Following the change of the base of calculation introduced in 2002 ('gross national revenue' was substituted for 'gross national product'), this global ceiling is today set at 1.24% of GNR (or 1.27% of GNP).

Table 1
The Evolution of Community Revenue from 1971 to 2005



Source: European Union 2005 Financial Report, calculations by the Centre d'analyse stratégique
* Corresponds to financial payments from 1970 to 1981 (prior to the own-resource system)

• This legal limitation naturally reflects the political choices taken by European institutions and Member States. It might evolve in the course of the coming revision of the community budget if the 27 countries of the EU succeed in reaching agreement concerning the need to significantly increase a given area of joint spending[7].
• A new rise in the level of the community budget, however, would not necessarily entail a structural modification of the present financing system insofar as, given its broad and stable basis, the 'GNR resource' appears capable of efficiently covering any eventual increase.

The search for a fair distribution of State contributions has led to constant adjustments

In the system of own resources first established in 1970, the annual contributions of States are no longer set *a priori*[8] but rather result from the profit accrued from various community resources: from then on, the evaluation of their fairness has been a recurrent object of discussion aiming to modify the relative share of various resources, but also diminish the 'net contribution' level of several Member States.

An 'own resources' distribution aiming to assure fairness in the gross contributions of Member States

• The establishment of the 'GNP' in 1988 also expressed a desire to base the financing of these expenditures on a resource that more closely conformed to the capacity of each Member State to contribute. This national 'preference' for the GNP/GNR explains why the latter assumed such an important role in financing the EU.
• The associated reduction in the share of the 'VAT resource' in financing the EU budget proceeds from the idea that it penalises the least prosperous Member States where the level of consumption (and thus VAT) tends to represent a greater share of national revenue[9]. This view led to a cap being placed on the base taken into consideration in the calculation of 'VAT resource' type contributions (today fixed at 50% of each state's GNR) and to the constant reduction in the rate of call applied to the VAT base (from 1.4% in 1985 to 0.3% in 2007 and beyond).
• In a context of international commercial liberalisation, the relative part of the TOR has similarly diminished following the lowering of customs tariffs. This reduction is also due to the refunds accorded for the 'collection fees' of these taxes, initially fixed at 10% and then raised to 25% of their sum total. Although applied to all Member States, these discounts were compared to 'disguised reductions for countries withdrawing a great deal from customs duties or agricultural taxes'[10].

The establishment of financial compensations benefiting certain 'net contributor' States

The search for a fair distribution of community budget financing has also contributed to recurrent debates concerning the level of acceptable 'net contribution' for Member States (the difference between their gross contribution and the expenditures from which they benefit), particularly in respect to their level of national wealth.
• It's in this context that one must set the emblematic 'British rebate"[11], which has since 1985 allowed a third of its theoretical gross contribution[12] to be returned to the United Kingdom.
• It's also in order to take account of the net contribution of certain Member States that financing for the compensation of Great Britain has been distributed in a differential manner: since 2002, Germany[13], Austria, Sweden and the Netherlands have thus benefited from a ¾ reduction in their theoretical contribution.

[7] On this subject, see Barbier-Gauchard and Bertoncini (2007), 'What are the concrete prospects for a rise in Community expenditure?', Centre d'analyse stratégique, *Strategic Newswatch* no.50, May 2007.
[8] In the system which preceded the 'own resource system', State contributions were distributed as follows: Germany, France and Italy, 28%; Belgium and the Netherlands, 7.9%; Luxembourg, 0.2%.
[9] An idea and argument reiterated by the European Commission in its '2005 Financial Report'.
[10] See the Report, 'The Future of the European Union's Own Resources', A. Lamassoure, European Parliament (2006/2205(INI)).
[11] Adopted by the 1984 European Council of Fontainebleau and established by the 'own-resources decision' of 1985.
[12] The expenditures related to recent or ongoing adhesions will be excluded from the calculation of the British rebate in 2009 and 2011.
[13] Between 1985 and 2002, Germany benefited from a 2/3 reduction of its contribution to the British rebate

• It's once again the definition of what are considered by the States to be 'fair' net contributions which led the December 2005 European Council to endorse the principle of two new corrections of national contributions:

- As for 'VAT resource': between 2007 and 2013, the rate-of-call applied to this resource (0.3%) will be reduced by 25% for Austria, 50% for Germany and 66% for the Netherlands and Sweden.
- As for 'GNP' resource: the Netherlands and Sweden will benefit from annual reductions in the amount of 605 and 150 million euros, respectively, over the same period.

In all, the financial correction mechanisms already at work or soon to be established have a non-negligible influence on the distribution between Member States of community budget financing (see Table 2).

Table 2
The Real and Potential Financial Consequences of Budgetary Correction Mechanisms

millions of euros	Initial Contributions	UK correction		Compensation from 2007 on		
		Rebate and its financing	Real contributions	GNR compensation	VAT compensation **	Potential contributions ***
Germany	19 766,4	369,9	20 136,3	151	**-1444,15**	18 843,2
Spain	8 789,8	685,1	9 474,9	64,93		9 539,8
France	15 424,2	1 429,9	16 854,1	121,555		16 975,7
Netherlands	5 892,0	55,1	5 947,1	**-565,74**	**-505,333**	4 876,0
Austria	2 103,7	40,3	2 144,0	16,61	**-81,575**	2 079,0
Sweden	2 614,4	39,9	2 654,3	**-129,615**	**-225,467**	2 299,2
United Kingdom	17 342,7	**-5 185,8**	12 157,1	126,84		12 283,9

Sources: EC Financial Report 2005, 'Distribution of Expenditures by Member State in 2005', calculations by the Centre d'analyse stratégique
* The Netherlands and Sweden also participate in the financing of their contributions proportionately to their share of the total GNR.
** The exact rate-of-call of the VAT in 2005 was at 0.3179%
*** An increase of Member State payments relative to the GNR would be generated by VAT compensation.

Debates over resource structure are inseparable from debates over spending structure

Discussions of EU financing are inseparable from discussions concerning the compensation from which certain countries benefit, a question that will occupy a central place in the 2008-2009 revision. Yet this latter debate is itself inseparable from discussions concerning the structure of community spending: if States seek compensation, it's because they do not approve the level of certain expenditures or the direct benefit they draw from them in the form of 'rates of return'. In this context, three scenarios can be envisaged for the 2008-2009 revision:

• The maintenance or light adjustment of the financial correction mechanisms established by the European Council in December 2005 as well as of the compensations obtained by States in the form of specific expenditures;

• More or less extensive modification of the distribution of expenditures between the national and community levels with the aim of creating a European spending structure capable of reducing demands for correction;

• The establishment of financing modes differentiated according to community policies: on the model of the European Social Funds in the 1960's or today's European Development Funds, this would consist in setting each Member State's contribution to a given policy by reference to its needs and its desire to participate (such a mechanism has been proposed, for example, for the common agricultural policy[14]).

The establishment of more transparent, incentive and autonomous financing has stimulated proposals but, so far, no action has been take on these

In recent years, the financing of the community budget has been the object of numerous reports and studies, particularly on the part of the European Commission[15] and the European Parliament[16], concerning the need to create a more transparent, incentive and autonomous own resources system. It is to be noted that these aims were not taken into consideration in the definition of the '2007-2013 financial framework' and that one of the issues at stake in the revision of the financial framework will be to examine whether they might be given a greater place in the future.

A more transparent system of community financing?

The increasing complexity of EU financing resulting from the multiplication of corrections and compensations benefiting Member States has given rise to a strong demand for transparency in order to render this financing less opaque for Member States and European citizens alike as well as to increase the accountability of the authorities charged with managing community funds[17]. This call for transparency has given rise to several recommendations:

• The first aims to establish a generalised correction mechanism to be applied to all EU Member States and replacing the present ad hoc correction mechanisms[18];

• The second proposes to make the 'GNR resource' the unique source of community budget financing as its principle and level are easily grasped[19];

• The third proposes the establishment of new 'own resources' to be directly collected from citizens and economic actors who would in this way be made more aware of the level of their contribution to the community budget and would thus show greater

[14] See Jorge Nunez Ferrer, 'Reforming the Own Resource System: What for?', Our Europe Conference, 19 April 2007.
[15] European Commission, 'Political Challenges and Budgetary Means of the Enlarged Union, 2007-2013', COM (2004) 101 February 2004.
[16] See 'The Future of the European Union's Own Resources', A. Lamassoure, European Parliament (2006/2205(INI)).
[17] See for example the European Commission, 'Financing the European Union', COM (2004) 505 final/2 September 2004.
[18] See the European Commission, 'Financing the European Union', op.cit.
[19] A proposition put forward by the Finish Presidency of the EU in 2004.

interest in how that budget was used: in this regard, the application of a community tax (on the order of 1%) to the VAT resource collected by Member States and reported on the bills delivered to consumers is a recurrent feature of this proposal[20].

A more incentive system of community financing?

The European Commission[21] has also called for the establishment of community taxes that will influence the behaviour of economic actors in order to bring this behaviour into conformity with the objectives of the EU and its Member States:

- The establishment of 'fiscal resources related to energy consumption' in order to internalise the external socio-economic costs on the environment of energy consumption. This tax system might be brought to bear on all types of transport or transport fuel (after the example of the 'kerosene tax') in the framework of the 'integrated European energy environment policy' inaugurated in March 2007;
- The creation of a resource based on business profits that would contribute to the good working order of the internal market by lifting one of the obstacles to cross-border economic activity while at the same time allowing reduction in the detrimental effect of fiscal competition between Member States in this domain;
- Transfer to the EU of a share of rights to indirect tobacco and alcohol consumer taxation in this way strengthening community consumer protection and public health policy.

A more autonomous system of community financing?

- The European Parliament and the European Commission[22] have on several occasions called for greater autonomy for the system of community financing in order to establish a more direct relationship between citizens and the resources transferred to the European Union budget as well as to limit the 'return rate' calculations in which a system essentially based on national contributions encourages States to engage.
- This strengthening of the autonomy of community financing might repose on the establishment of:
  - An entirely new tax whose all or some part of the product would be allocated to the EU budget (e.g., the CO2 tax);
  - A direct community tax (e.g., the business tax)[23] to be in part substituted for the national tax;
  - Additional taxes which would also be partly substituted for taxes already collected by Member States (e.g., direct VAT at 1%). Of the three, this option is the most often considered.
- The possibility of promoting a given additional community tax depends at once on the degree of prior harmonisation of the bases applied at the national level and on the more or less homogenous character of the rates practiced by Member States. For both of these reasons, two types of additional taxes are now easier to imagine – on the one hand in the area of the VAT, on the other in the area of energy.
- While none of the 10 or 12 new resources frequently cited in discussions of how to increase the EU's financial autonomy have so far been adopted, it must be stressed that the ability to respond to certain technical and political conditions (in particular, efficiency, fairness, transparency and economic impact[24]) have already been evaluated (see Table 3).

Table 3
Evaluation of Potential New Own-Resources for the EU (examples)

	Sufficiency	Fair contributions	Transparency	Efficient allocation
Modulated VAT	***	**	***	**
EU Corporate Income Tax	**	**	**	***
Excise duties tobacco & alcohol	**	*	**	**
Energy Taxation	***	**	**	***
Kerosene Tax	*	***	**	***

Source: Cattoir P. (2004), 'Tax-based EU Own Resources: An Assessment', European Commission DG TAXUD, Working paper no. 1/2004

Bringing historical and political perspective to the evolution of the EU's financial system allows us to observe that considerations aiming to reinforce the efficiency and fairness of this system have until now dominated community discussions, rather than demands for transparency and autonomy. This is not necessarily an indication of the attention that may be accorded any given objective during the revision of the EU 2008-2009 budget. It also leads us to underscore that, should no compromise satisfy all of these objectives at once, arbitration and compromises will necessarily be concluded in order to give rise to consensus between Member States, and between the Council, Commission and the European and national parliaments.

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[20] See for example the European Commission, 'Financing the European Union', op.cit.
[21] See the European Commission, 'Financing the European Union', op.cit.
[22] See for example the European Commission, 'Financing the European Union', op.cit.
[23] The idea of a direct tax on citizens was ruled out by the Lamassoure report for reasons related to its political palatability.
[24] The Cattoir study and the Lamassoure report refer to the same 8 conditions: 'profitability', stability, simplicity, low administrative costs, efficient allocation of resources, vertical equity (redistributive effects), horizontal equity (for taxpayers) and equity between States.