Briefing

Financing public expenditure: some key figures at EU and national levels

*The **Member States'** structure of **revenue** is **stable** over time and their sources of revenue are **diversified**. Moreover, the size of the Member States' **budget is** generally **increasing**.*

*Conversely, the financing structure of **the European Union** has **changed over time** and the sources of revenue are **not diversified**. The **EU budget** size is **levelling off**.*

*Very small in size compared to national budgets, the **EU budget** is an **investment budget** with a strong leverage effect, i.e. one euro spent from the EU budget generates more than one euro in investment.*

*Today, around **83%** of the total EU revenue **comes from** two resources which are, in fact, **financial transfers from national budgets** (GNI- and VAT-based resources) and cannot be seen as true own resources for the EU as defined in the Treaty. In particular, the VAT-based resource, contrary to its name, is not levied on the final consumer but collected on a Member State statistically computed VAT base.*

*In addition, specific arrangements granted to some Member States to reduce their contributions increase the **inconsistency among Member States** and the **complexity** of the system. Therefore, the current system to finance the EU is difficult to understand for most EU citizens.*

1 Trend on revenues: an increase for the Member States, a levelling for the EU

Over time, revenues to finance national budgets or the EU budget display a different picture. Excluding the 2008 fall which result from the financial crisis, tax revenues to finance national budgets are increasing. The last two years show a sharp increase. However, the EU revenues exhibit a flat development.

Moreover, the size cannot be compared: around **40% of GDP for the Member States and around 1% for the EU budget**.

However, the difference is not only coming from the size of the budgets but also from the **particular nature of the EU budget**.

The **EU budget** is **an investment budget with a strong leverage effect**. The EU budget pools the resources and **creates economies of scale**. The 28 national budgets and the European budget (the 29 one) are complement each other.

The EU budget finances actions that Member States can **fund more effectively** by working together. Moreover, the **EU budget funds investment projects** that otherwise **would not be realised**.

Actually, 94 % of it goes back to the Member States and European citizens through EU policies and programmes, and therefore the EU budget is a tool to boost investment, growth and jobs in Europe.

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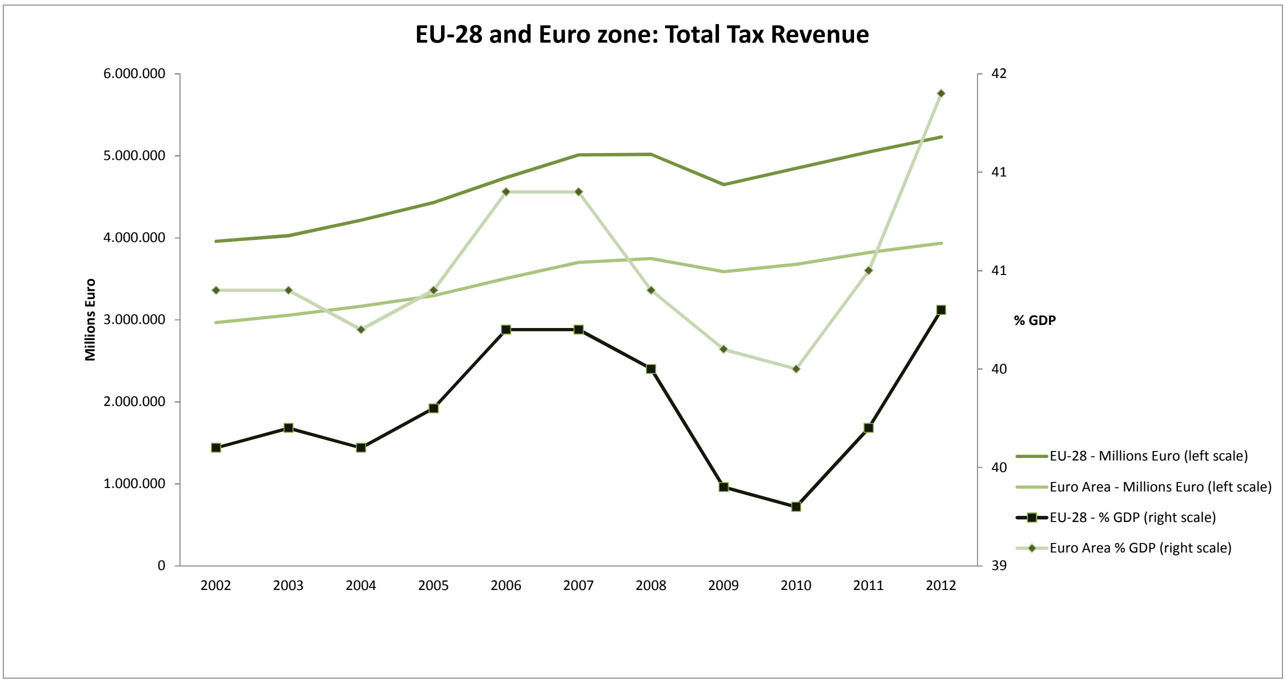
To strengthen Europe's competitiveness and to stimulate investment for the purpose of job creation the new Commission headed by President Juncker has proposed an **Investment Plan**[1] to unlock public and private investments in the real economy of at least € 315 billion over the next three years (2015-2017).

Furthermore, in its resolution on the general guidelines for the 2015 budget, as well as in its resolution on the draft general budget of the Union for the financial year 2015, the **European Parliament** underlined the role of the EU budget in reinforcing strategic investment in actions with European added value, highlighted the role of the European Structural and Investment Funds in sustaining public investment, called for enhanced use of 'innovative financial instruments', particularly in respect of long-term investments.

Graph 1 shows the tax revenue aggregation for EU-28 and the Euro area over time and graph 2 shows the development of the EU budget.

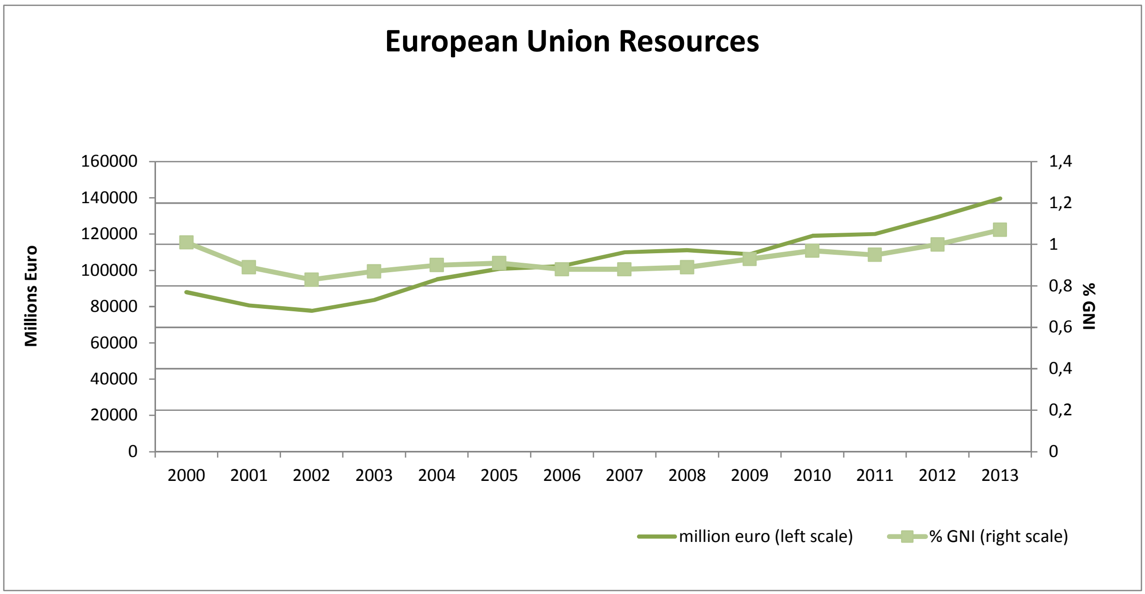
Graph 1 - EU-28 and Euro zone total revenue



Source: Eurostat

[1] An Investment Plan for Europe, communication from the Commission, COM/2014/0903

Graph 2 - European Union Resources



Source: European Commission - EU Budget 2013 - Financial Report

2 Structure of the revenue: where the revenue comes from

2.1 Member States' revenue: A common structure, stable over time

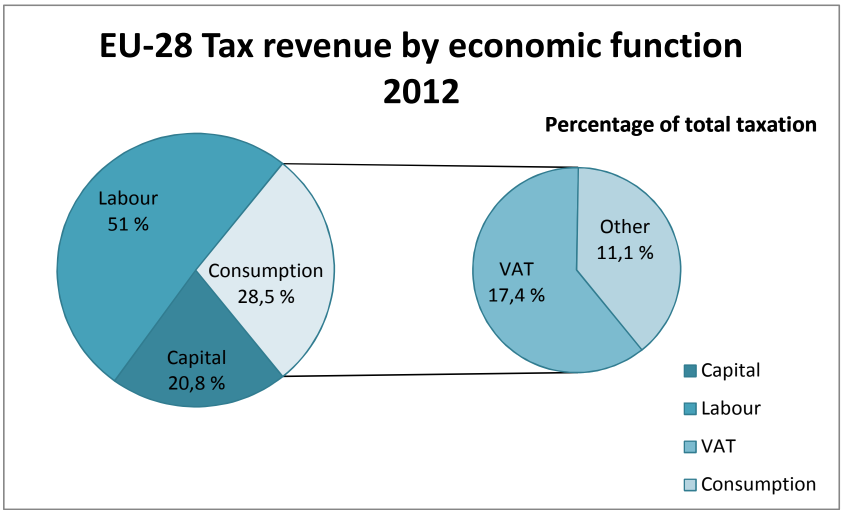
Consumption, labour income and capital constitute the different tax bases. The distribution of the total tax revenue for EU-28 by these three types of tax base for the latest year available (2012) is shown in the graph below.

Labour income provides the largest source of revenue, around half of the total, followed by consumption taxes, around one third, followed by capital at around one fifth.

Within the consumption figure, VAT represents the greatest share. Revenue from VAT accounts for 17% of the total tax revenue.

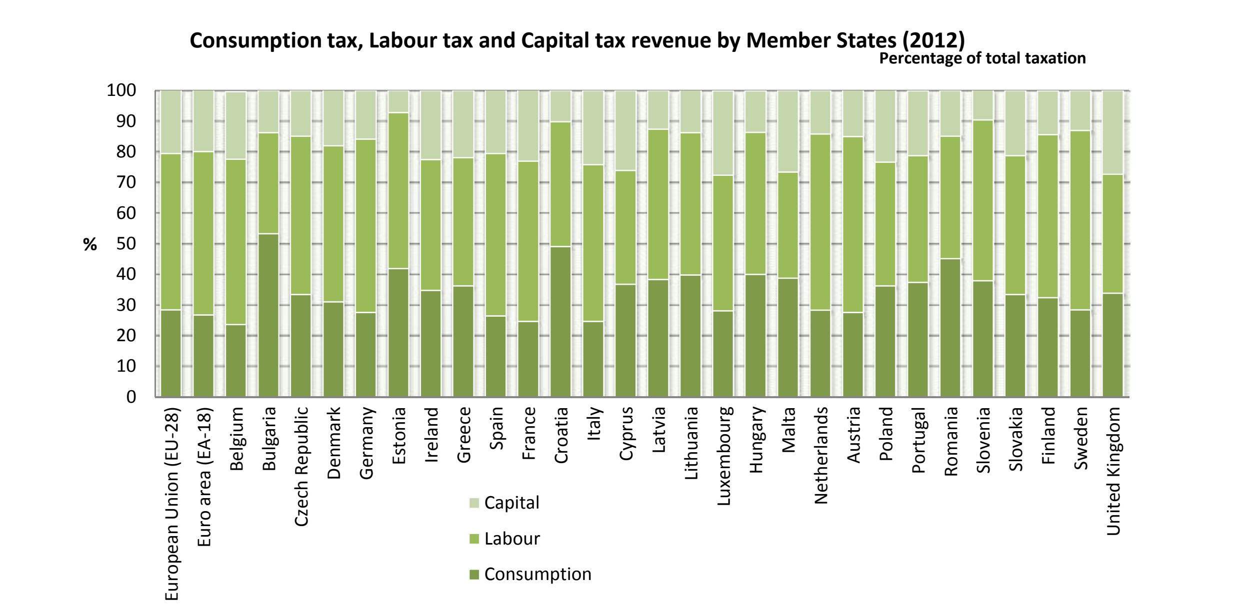
This structure of revenue is stable over time. However, the structure differs for the "new" Member States where a higher proportion of their revenue comes from consumption taxation and a somewhat lower proportion from labour. Bulgaria and Croatia stand out with around half of all revenue coming from consumption taxes.

Graph 3 - EU-28 tax revenue by economic function 2012



Source: Eurostat

Graph 4 - Consumption tax, labour tax and capital tax revenue by MS 2012



Source: Eurostat

2.2 The EU revenue: a very specific structure, changing over time

Article 311 of the Treaty on the functioning of the European Union states that "*the Union shall provide itself with the means necessary to attain its objectives and carry through its policies. Without prejudice of other revenue, the budget shall be financed wholly from own resources*". In addition, article 323 makes clear "*the European Parliament, the Council and the Commission shall ensure that the financial means are made available to allow the Union to fulfil its legal obligations in respect of third parties*".

Moreover, contrary to the Member States, the **European Union is not allowed to borrow** to finance its policies or to cover any budget deficit[2] neither does it have the power to raises taxes on its own. In practice, this balance principle implies that each year the **EU budget has to be in equilibrium** and revenue is determined according to the expenditure. In addition, the overall volume of EU revenue is restricted by a ceiling, which, for the 2014-2020 period, is set at 1.23% of the EU GNI.

Finance for the EU budget comes from three types of own resources:

Traditional own resources consist of custom duties, agricultural duties and sugar and isoglucose levies which result directly from the existence of a unified customs area and are collected by Member States. Moreover, the Member States are authorized to retain a share of the collected amount as collection costs, for the 2014-2020 period this share will amount to 20% as opposed to 25% during the 2007-2013 period.

VAT-based own resource is a complex calculation based on a theoretical harmonised VAT base statistically computed for each Member State. Currently, the VAT base is not fully harmonised across Member States as derogations continue to exist and different types of VAT rates are present. Therefore, this VAT resource is **not levied directly on the final consumers** (who actually bear the VAT burden) but on the net VAT revenue collected, corrected and adjusted in order to obtain a harmonised VAT base. In other words, this resource comes from national budgets. Moreover, the **capping mechanism** in place on this resource (currently 50% of GNI) directly transforms it into a GNI-based resource for the Member State concerned (e.g. in 2014: five Member States where concerned).

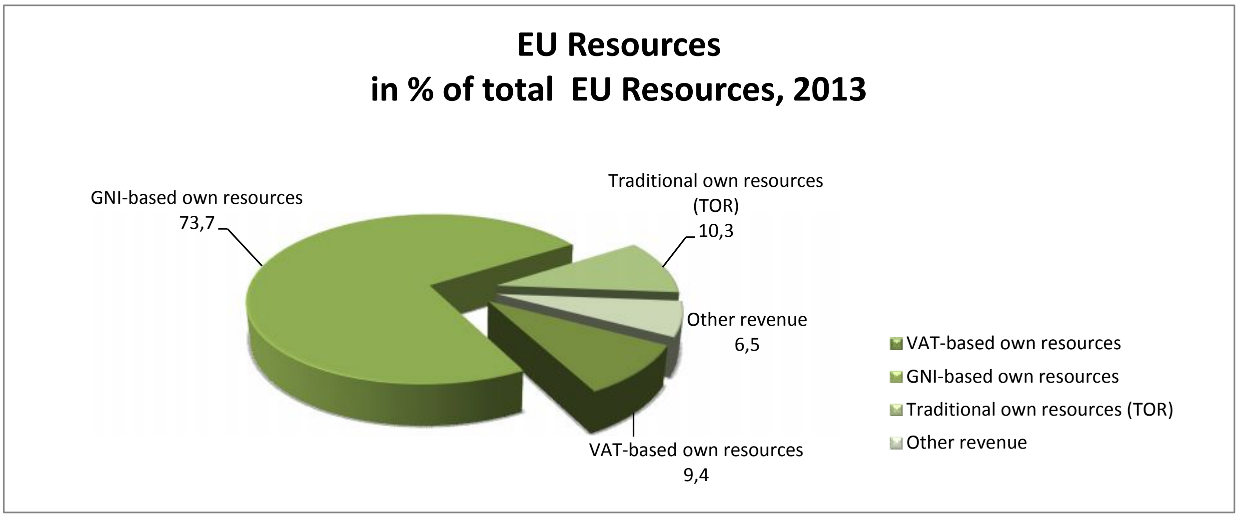
[2] Article 310 311 of the Treaty on the functioning of the European Union "*the revenue and expenditure shown in the budget shall be in balance*".

It should also be stressed that any **frauds to VAT** like "carrousel fraud" **directly impact the EU revenue**. In 2013, the European Commission estimated the total losses, including fraud and evasion but also legal tax avoidance, bankruptcies and financial insolvencies to 1.5% of the EU GDP.

GNI-based own resource is a fixed percentage of Member States' GNI. Initially created to **play the role of balancing the EU budget**, this resource **has grown to represent more than two thirds of the total revenue**, around 74% in 2013.

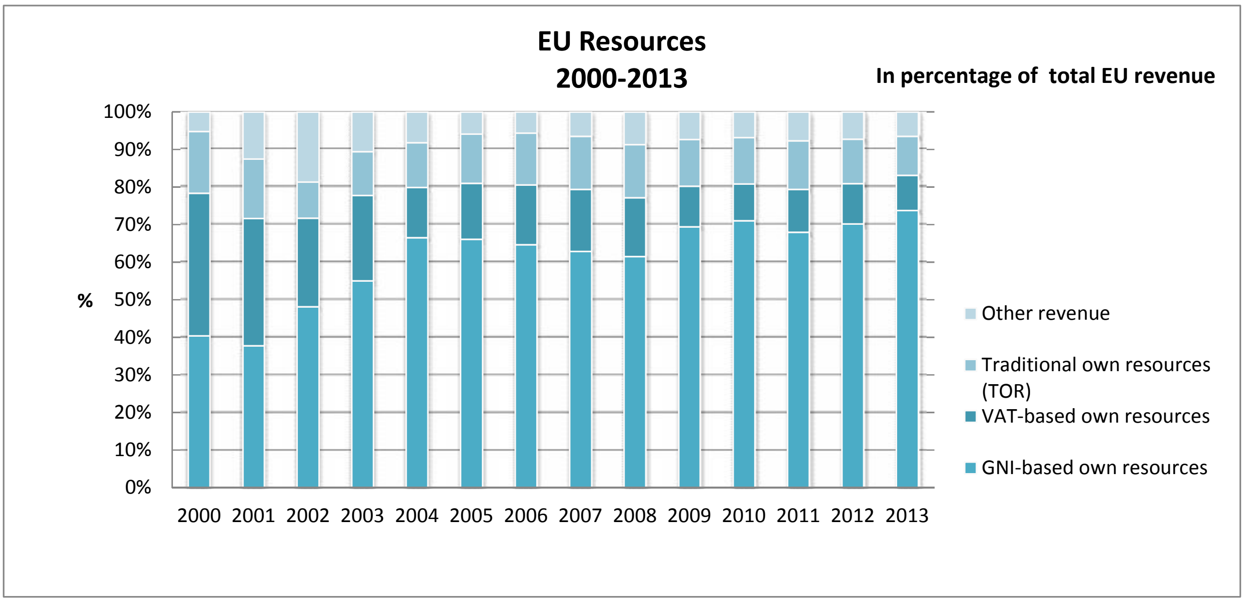
Finally, **other revenue**, which is not called own resources, comes from fines to companies breaching EU competition law or other EU laws, contributions of non-EU countries to specific EU programmes and taxes on EU staff.

Graph 5 - EU resources in % of total EU resources 2013



Source: European Commission - EU Budget 2013 - Financial Report

Graph 6 - EU resources 2000-2013



Source: European Commission - EU Budget 2013 - Financial Report

Compared to the share of VAT revenue in the total revenue for Member States, the share of the VAT-based resource in the EU budget is much smaller, more than 17% of the total revenue for Member States against around 9% in the EU budget. In addition, the way the VAT-based resource is computed, and the capping mechanism, make it closer to the GNI resource rather than to the "real" Member States VAT levied on the final consumer.

To sum up, the current system of resources can be seen as far from the spirit of the Treaty on own resources. Own resources are not "genuine" as around 83% of EU revenue comes directly from the national budgets (GNI-based resource and VAT-based resource) and are contributions rather than own resources.

Finally, the way Member States record their contributions to the EU budget in their own national budgets is diverse[3]. Some attribute their contributions to the EU budget directly as appropriations and, therefore, as a reduction of the central government income but the majority consider their contributions as government expenditure and, therefore, opening the argument for a reduction in government expenditure.

Moreover, additional corrections granted to some Member States in the financing of the EU budget increase the complexity and opacity of the system.

At the **request of the European Parliament** in the context of the difficult negotiations over the new Multiannual Financial Framework 2014-2020 **a High Level Group on Own Resources** was created on February 2014 to reflect on **finding more transparent, simple, fair and democratically accountable ways to finance the EU**. The group will deliver its final recommendations by 2016, at the mid-term review of the current Multiannual Financial Framework.

The group is chaired by former Italian Prime Minister and EU Commissioner Mario Monti and is composed of members designated by the European Parliament[4], the European Commission and the Council.

It is for the first time that such a high level group is established at the inter-institutional level. It demonstrate the awareness of European actors that somehow, in this issue lies one of the keys to addressing a range of budgetary challenges and to **unlocking the real economic potential of the EU budget**. Ignoring the issue could entail high opportunity costs for cohesion, growth and political integration. Own resources are an issue which can be only be confronted together by all Member States and by all institutions. A viable way out of the gridlock pre-supposes a shared understanding of the functioning and the role of the EU budget and its financing side in particular.

The **First Assessment Report** delivered by end of 2014 depicts the present financing system of the EU budget, which is mainly based on what is perceived as **national contributions rather than genuine own resources**. It also describes recent reform efforts and provides guidelines for the upcoming work, in particular the criteria and broader issues which need to be examined further to create the conditions for reform. It acknowledges the **great obstacles to reform the current system** and **aims at finding practical answer**s, in particular by enlarging the debate to "a comprehensive analysis of the problem, comprising economic, budgetary, institutional and political aspects", which has not been done in the past. All these relevant questions will have to be addressed in the upcoming working process in 2015 and 2016.

[3] « How do Member States handle contribution to the EU budget in their national budgets", European Parliament study by J. Mortensen, J. Nuñez Ferrer and F. Infelise, October 2014.

[4] European Parliament members are: Ivailo Kalfin, Former MEP, Deputy Prime-Minister of Bulgaria and Minister of Labor and Social Policy; Alain Lamassoure, MEP (EPP) and Guy Verhofstadt, MEP, (ALDE).

2.3 EU budget financing: discrepancies between Member States,

The following table shows the specific arrangements applicable to some Member States. **12 Member States out of 28** (i.e. around **43% of all Member States**) enjoy specific arrangements in one or several ways.

Table 1 - **Specific revenue arrangements to some Member States**

Member State	*Capping VAT base (50% GNI)*	*Reduced VAT call rate in % (Normal call rate 0.3%)*		*Reduced GNI contribution Lump sum reduction In million EUR*		*Op-out adjustment Deduction for not taking part in Union action or policy*	*UK Rebate*	*Reduced participation in bearing cost of UK rebate Reduction of 75% of the amount due*
		2007-2013	2014-2020	2007-2013	2014-2020			
Denmark					130 *per year*	✓		
Germany		0.15	0.15					✓
Ireland						✓		
Croatia	✓							
Cyprus	✓							
Luxembourg	✓							
Malta	✓							
Netherlands		0.10	0.15	✓	695 per year			✓
Austria		0.225			30 *in 2014* 20 *in 2015* 10 *in 2016*			✓
Slovenia	✓							
Sweden		0.10	0.15	✓	185 *per year*			✓
United Kingdom						✓	✓	

Source: Council Regulation 608/2014 26 May 2014 (Official Journal of the European Union L 168 7.6.2014)

Outside the capping of the VAT base to 50% of the GNI which, currently, is theoretically granted to all Member States, a quarter of the Member States enjoy specific resource arrangements. Moreover, the new 2014-2020 period does not see any reduction in the number of specific resource arrangements.

It should be also mentioned that the high percentage[5] that Member States are authorised to retain as costs for the collection of the traditional own resources can be seen as another form of rebate for Member States with high customs duty collection. Currently, more than half of the traditional own resources is collected by just a handful of Member States[6].

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[5] 25% then 20% for the new Multiannual Financial Framework for 2014-2020. A Commission Staff Working Paper - SEC (2011) 876 - shows that these percentages of collection costs do not correspond to the actual costs incurred.

[6] DE, UK and NL

2.4 Member States' contributions to financing the EU budget: divergences

The two graphs below express Member States' contributions to the EU budget both in euro per capita and as a percentage of their GDP for 2013. In order to ease the reading, these two graphs present Member States ranked from high to low.

A comparison of the two graphs shows interesting information. Some Member States which present a rather high contribution in terms of per capita figures are actually contributing at a lower level relative to their wealth measured by the GDP.

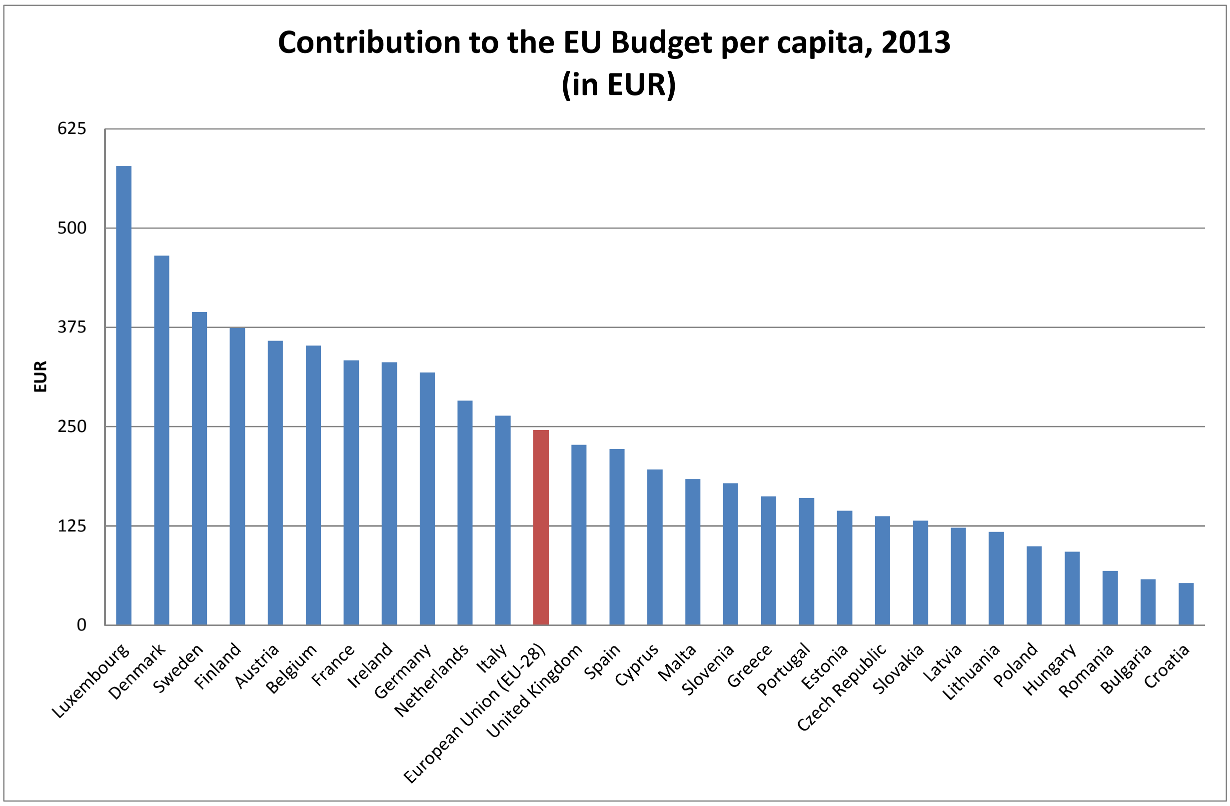
Luxembourg's contribution, which is the highest value in terms of euro per capita, is far below the average with a contribution of 0.68% of its GDP. However, Luxembourg's case can be seen as particular as most of its GDP is the result of the work of commuters and, therefore, can explain its low percentage in terms of GDP in the financing of the EU budget. Croatia has just joint the European Union and stands the lowest in the two measurements.

With a contribution per capita of 318 euro, well above the EU average, Germany stands at the EU average in terms of percentage of GDP.

Actually, 24 Member States contributions' are located in a narrow range between 0.90% and 1.07% of their GDP (it should be noted that this range is smaller than the average plus and minus one time the standard deviation).

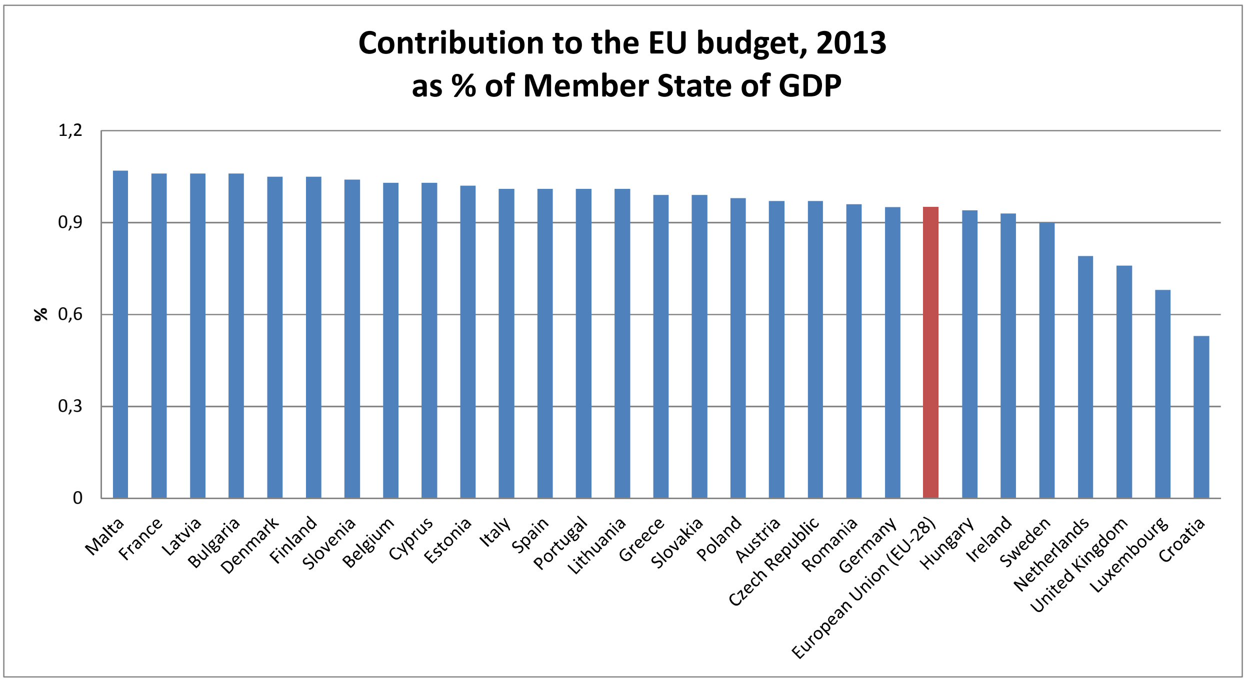
Both in terms of euro per capita and in percentage of GDP, the United Kingdom's contribution is below the average. Furthermore, the United Kingdom ranks third for the lowest contribution in term of percentage of GDP with 0.76%.

Graph 7 - Contribution to EU Budget per capita (in EUR), 2013



Source: Eurostat; European Commission - EU Budget 2013 - Financial Report

Graph 8 - Contribution to EU Budget as % of GDP, 2013



Source: Eurostat; European Commission - EU Budget 2013 - Financial Report

ANNEX - EU National contributions, 2013

	GDP (million EUR)[1]	Population[1]	GDP per capita (in EUR)	Contribution to EU budget (million EUR)[2]	Contribution to EU budget per capita (in EUR)	Contribution to EU budget per capita per day (in EUR)	Contribution as % of GDP	Contribution as % of EU budget	Allocated expenditure as % of EU allocated budget (%)
	(1)	(2)	(3)=(1)/(2)*1.000.000	(4)	(5)=4/2	(6)=(5)/365	(7)=4/1	(8)	(9)
Belgium	382.692	11.161.642	34.286	3.931	352,21	0,96	1,03%	3,2%	5,4%
Bulgaria	39.940	7.284.552	5.483	423	58,04	0,16	1,06%	0,3%	1,5%
Czech Republic	149.491	10.516.125	14.215	1.445	137,41	0,38	0,97%	1,2%	3,6%
Denmark	248.975	5.602.628	44.439	2.606	465,14	1,27	1,05%	2,1%	1,1%
Germany	2.737.600	82.020.578	33.377	26.125	318,52	0,87	0,95%	21,0%	9,7%
Estonia	18.613	1.320.174	14.099	190	144,13	0,39	1,02%	0,2%	0,7%
Ireland	164.050	4.591.087	35.732	1.521	331,22	0,91	0,93%	1,2%	1,4%
Greece	182.054	11.062.508	16.457	1.794	162,18	0,44	0,99%	1,4%	5,4%
Spain	1.022.988	46.727.890	21.892	10.376	222,04	0,61	1,01%	8,3%	10,2%
France	2.059.852	65.578.819	31.410	21.874	333,56	0,91	1,06%	17,6%	10,6%
Croatia	43.128	4.262.140	10.119	227	53,21	0,15	0,53%	0,2%	0,2%
Italy	1.560.024	59.685.227	26.138	15.748	263,85	0,72	1,01%	12,7%	9,3%
Cyprus	16.504	865.878	19.060	170	196,36	0,54	1,03%	0,1%	0,2%
Latvia	23.372	2.023.825	11.548	248	122,69	0,34	1,06%	0,2%	0,8%
Lithuania	34.631	2.971.905	11.653	349	117,58	0,32	1,01%	0,3%	1,4%
Luxembourg	45.478	537.039	84.683	310	578,17	1,58	0,68%	0,2%	1,2%
Hungary	97.948	9.908.798	9.885	920	92,87	0,25	0,94%	0,7%	4,4%
Malta	7.263	421.364	17.236	78	184,03	0,50	1,07%	0,1%	0,1%
Netherlands	602.658	16.779.575	35.916	4.745	282,76	0,77	0,79%	3,8%	1,7%
Austria	313.067	8.451.860	37.041	3.028	358,21	0,98	0,97%	2,4%	1,4%
Poland	389.695	38.533.299	10.113	3.831	99,41	0,27	0,98%	3,1%	12,0%
Portugal	165.690	10.487.289	15.799	1.679	160,09	0,44	1,01%	1,3%	4,6%
Romania	142.245	20.020.074	7.105	1.369	68,38	0,19	0,96%	1,1%	4,1%
Slovenia	35.275	2.058.821	17.134	368	178,80	0,49	1,04%	0,3%	0,6%
Slovakia	72.134	5.410.836	13.331	713	131,85	0,36	0,99%	0,6%	1,5%
Finland	193.443	5.426.674	35.647	2.032	374,36	1,03	1,05%	1,6%	1,1%
Sweden	420.849	9.555.893	44.041	3.769	394,40	1,08	0,90%	3,0%	1,2%
United Kingdom	1.899.098	63.896.071	29.722	14.510	227,08	0,62	0,76%	11,7%	4,7%
EU28	**13.068.757**	**507.162.571**	**25.768**	**124.378**	**245,24**	**0,67**	**0,95%**	**100%**	**100%**

[1]Eurostat data

[2]Commission document "EU budget 2013 financial report". The difference with the "total own resources payments presented in Table 2 comes from the exclusion of traditional own resources (customs duty, etc.)

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