

## Financing the EU budget: What does the academic world tell us?

*The European Parliament's position advocating a reform of the current revenue system and more genuine own resources to finance the EU budget appears to be strongly backed by academic research.*

*There is a broad consensus that the current system to feed the EU budget is no longer viable. National contributions currently account for more or less 85% of the budget.*

*The net payer debate is seen as misleading and polluting discussions on the EU budget. The accounting calculations on which it is based are arbitrary and do not reflect the real net benefits and costs of the EU budget.*

*Academic research provides numerous analyses of the best options to reform the current system of own resources and to bring back the GNI resource to its initial balancing role.*

*As Andreis and Marè (2014) stated in their conclusions, the EU budget is a key condition for the evolution of European integration, and also part of the debate on the legitimacy of the Union's action. Indeed, debating the EU budget is actually discussing competing visions of Europe's future. Therefore, an agreement on the future of the EU is a pre-condition for resolving the issue of financing the EU budget.*

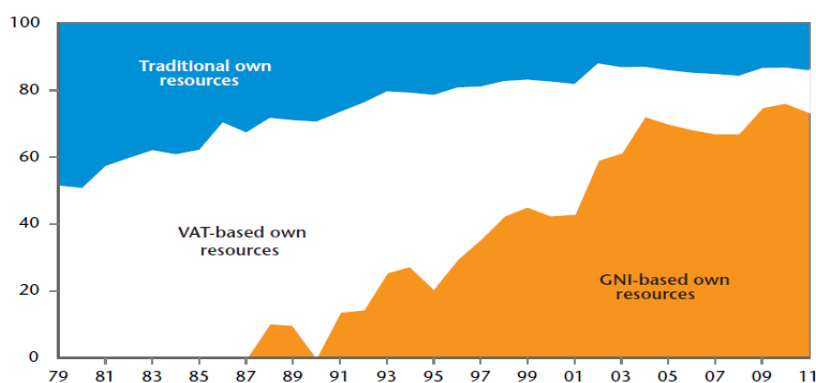
### EVOLUTION OF THE EU FINANCING

The evolution of the EU financing is well documented and is the starting point of discussions about the EU resources.

The decreasing trends of Traditional Own Resources and the VAT-based resource, which result in a **system mainly based on national contributions**, is seen as the source of a number of policy problems<sup>1</sup>.

The European Commission's well-known graph on the composition of the own resources (below) can be found in numerous papers.

Figure 1. Composition of EU revenues from own resources



Source: European Commission, 2012.

<sup>1</sup> The traditional own resources consist of agricultural levies and custom duties. The VAT resource is computed on a theoretical harmonised tax base with a uniform call rate, subject to capping. The GNI resource, originally a balancing item, has, over time, become the largest source of revenue for the EU budget.

### **VAT resource: A contribution rather than a genuine own resource in practice**

The VAT resource is based on a uniform call rate computed on a theoretical harmonised VAT base. These complex calculations are required in order to take account of varying zero, reduced or standard rates among Member States. In other words, not only do the VAT rates differ, but also the VAT base in the EU is not fully harmonised. In addition, this theoretical harmonised VAT base is capped and some Member States were granted reduced call rates in order to receive rebates. Therefore, this VAT resource can be viewed more as a financial contribution close to the GNI resource rather than a genuine own resource. Over time the proportion of revenue coming from the VAT resource has declined regularly and is now around 11% of the total EU revenue.

### **Current situation: Far from the Treaty's spirit**

Researchers point out that the current situation is far from the spirit of the Treaty. D'Oultremont *et al.* (2013) underline the question whether the vast majority of the EU budget funding is truly consistent with the Treaty provision just by being called "own resources" of the EU. Legally speaking, the GNI resource and the VAT resource are part of the Own Resources Decision that allocates them as resources that the EU is entitled to receive: in economic terms, they are not genuinely own resources that belong to the EU level. Indeed, they are **inter-governmental transfers** financed by the wide range of national taxes, rather than an identifiable single tax or other revenue that EU citizens can associate with the EU budget<sup>2</sup>.

Many papers highlight the need for financing to be linked with the EU citizens/taxpayers, which is not at all the case at present with the GNI based contribution.

## **CORRECTION MECHANISMS AND NET-PAYER DEBATE**

### **Correction mechanisms**

All papers advocate a complete elimination of the UK rebate and its by-products (rebate to some Member States on the financing of the UK rebate, lump-sum payment to others) to allow for a more simple and transparent system of financing the EU budget.

From an economic point of view, all analyses came to the conclusion that the motive to grant a rebate to the UK has diminished over time.

### **The net payer debate: A misleading accounting exercise**

The net payer debate is seen as misleading and is polluting discussions on the EU budget (De la Fuente 2010). The calculations on which it is based are arbitrary and do not reflect the net benefits and costs of the EU budget. Based on an accounting exercise, it fails to take into account all economic flows between all Member States or simply the access to the internal market. Therefore, as highlighted in Schratzenstaller (2014), the net contribution position cannot reflect the entire economic impact of European integration upon Member States.

Using a simple input-output model, Cipriani and Pisani (2004) demonstrate that some Member States, currently considered as net contributors, would actually become net beneficiaries if the increase in production from which they benefit were taken into account.

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<sup>2</sup> The same analysis can also be traced back on the European Parliament side, e.g. MEP Lamassoure's report on the future of the European Union's own resources (2006/2205INI).

These views are entirely shared by the European Parliament, e.g. Haug *et al.* (2011): *"this narrow-minded accounting approach is rooted in a vision of the process of European integration as a 'zero-sum' game, in which what some countries win is always at the expense of others. It fails to understand that most EU policies, and the process of integration itself, generate mutual benefits"*.

## THE NEED TO REFORM THE SYSTEM TO FINANCE THE EU BUDGET

### A consensus to reform the current system

Reflections on the need to reform the financing of the EU are not recent. Deep analysis and proposals for reforms can be traced back at least to the end of the last century, see for example the works of Begg *et al.* (1997) or Prof Gretschmann (1998).

There is a broad consensus that the current system to feed the EU budget is no longer viable. National contributions currently account for more or less 85% of the budget. As pointed out in Matthijs (2014), the **present own resources system** is nonetheless **extremely complex** with the GNI contributions largely replacing the own resources. It is **not transparent**, particularly with several Member States being allowed to apply corrections to the calculation of the VAT and the GNI, and the UK being singled out for a rebate. A new system of own resources would require a **simplification of the rules**. The current system is not applied to all Member States in the same way.

Moreover, several papers stress that the current own resources system is one, if not the only, most important causes for the existing shortcomings on the expenditure side of the EU budget.

### Criteria to assess new resources

Academic research provides numerous analyses of the best options to reform the current system of own resources and develop criteria to assess new resources. The choice of the criteria to evaluate the positive and negative side of the potential new own resource is not entirely neutral as it could reflect personal interest or normative preferences. However, assessing new resources against principles of **simplicity, transparency, equity** and **democratic accountability** is now well established see for example Cipriani (2014) or Monti (2014).

### Different proposals for a reformed system

Different sets of criteria can produce different best options, but the proposal for a new VAT system appears to be one of the top candidates. It would create a direct link between the citizen and the EU budget financing without additional costs, as VAT is already recovered by Member States and the EU rate would be offset by an equivalent decrease of the national rate. In addition, it would give new impetus to the development of the internal market through an increased harmonisation of national VAT systems.

However, given that the current VAT-based own resource is part of essential data for calculating the UK correction, the debate on the elimination of the current VAT resource is directly linked to the discussion on the correction mechanisms, see d'Oultremont *et al.* (2013).

The need **to bring the GNI resource back** to its initial **balancing role** is also very well documented, see Cipriani (2014), Schratzenstaller (2013 or d'Oultremont and Mijs (2013)) to quote just a few.

It should also be noted that an analysis done by the ZEW and commissioned by the German federal Ministry of Finance advocates a financing of the budget fully on the basis of the GNI resource. They identified the link between the EU budget and national budgets as a key advantage since it sets a strong incentive for the Council to control spending at the EU level (Heinemann *et al.* 2008). However,

this approach is in the minority within the academic research. Actually, most of the works support a clearer link between the EU financing and the EU citizens.

On the other hand, many other contributions analyse, in depth, the creation of new resources such as a financial transaction tax, a carbon tax or an EU corporate income tax, amongst other proposals. However, all new resources pre-suppose the ability to recover and to check them. Currently, most of the research focusses on the economic effects and the potential revenue from the new resource, but little is done on the process to effectively put the new resource in place.

### **The difficulties to reform**

Finally, analysis points out political difficulties arising from, amongst other reasons, the unanimity rule. Many papers conclude that, unless a strong political will to deepen EU integration comes to light, the likelihood of a big change is small.

Becker (2014) stresses that the debate about a genuine European own resource is closely linked to fundamental questions about the future and the aim of the European integration process, the autonomy of the EU from its Member States and institutional questions of representation in the Parliament and, hence, the statehood of the European Union. Therefore, the issue can only be really settled by a fundamental decision on the future of Europe.

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### LIST OF MAIN REFERENCE DOCUMENTS<sup>3</sup>

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Clémentine d'Oultremont; Arnout Mijs (2013), *"Reforming the system of financing the EU budget"*, Working paper European Affairs Programme, Egmont Royal Institute for International Relations.

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<sup>3</sup> References on this issue are numerous and cover more than 20 years, in this brief the focus is mainly but not only on the last two years, i.e. 2013 and 2014.

Margit Schratzenstaller (2014), "*Reform options for the EU's system of own resources*", revue de l'OFCE / Debate and Policies n° 132.

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