
Reforming the System of Financing the EU Budget



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- Clémentine d'OULTREMONT & Arnout MIJS -

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AUTHORS:

Clémentine d'OULTREMONT is Research Fellow at the Egmont Institute –
The Royal Institute for International Relations

Arnout MIJS is Research Fellow at the Clingendael Institute –
The Netherlands Institute of International Relations

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INTRODUCTION

Though traditionally the main focus of the EU Budget debate is on the expenditure side, the financing side of the story also needs to be addressed. The controversial part of this story is undoubtedly the call for more “genuine” EU own resources and the correction mechanisms that allow some Member States to reduce the difference between what they pay into the EU budget and what they receive from it.

The financing of the EU budget has evolved significantly over the years. Today, national contributions are responsible for about 86% of the EU budget. Yet, since the foundation of the EU, the various Treaties have always promoted EU financial autonomy through the principle that “the budget shall be financed wholly from own resources”.¹ Initially, the resource based on Gross National Income (GNI) was marginal compared to “genuine” EU own resources, i.e. resources that are levied at the EU level. The increase of the GNI-based resource has been associated with a growing use of correction mechanisms. In this logic of *juste retour*, Member States tend to focus on their own net financial balance rather than privileging European public interest.

Therefore, there is an increasing call for the funding of the EU budget to rely more on genuine own resources. Beyond a return to the spirit of the Treaty, the introduction of more genuine own resources in the EU budget could mitigate the *juste retour* issue, increase visibility and accountability to the EU citizens, and contribute to the pursuit of EU policy objectives.

In the framework of the adoption of a new Multiannual Financial Framework (MFF) for the period 2014-2020, the European Commission has therefore come forward with an ambitious proposal introducing new genuine own resources to finance the EU budget, modifying the current mechanisms via a system of lump-sums, and reducing the collection costs on the proceeds from traditional own resources. The proposal has retained two new genuine own resources, namely a new Value Added Tax-based resource and a Financial Transaction Tax

¹ Article 311 of the Treaty on the Functioning of the European Union.

(FTT)-based resource. Although the different elements of this proposal are likely to be difficult to approve politically, the present paper aims to analyse each of them so as to understand how they could improve the current system.

After a quick overview of the evolution of the EU financing system until today (part 1), this paper will examine why more genuine own resources are needed but politically difficult to adopt (part 2). Then, the proposed EU financing system for the next MFF 2014-2020 will be analysed (part 3).

1. EVOLUTION OF THE EU FINANCING SYSTEM UNTIL TODAY

1.1. The shifting composition of the EU financing system

The financing of the EU budget has evolved significantly over the years. Directly linked to the evolution of the EU policies, the discussions on the EU own resources have always been a source of tensions between Member States. The Treaty foresees that "without prejudice to other revenue, the budget shall be financed wholly from own resources".² The term "own resources" is mostly used in a "generic sense" as referring to the different revenue sources of the EU budget. Yet, it also reflects a political goal, namely that the EU should be financed independently from Member States and their financial contributions. However, the reality is quite different.

At present the EU budget is composed mainly of four own resources, which altogether cannot exceed 1.24% of all the Member States' GNI. The traditional own resources, namely the custom duties and agricultural levies, amount to 13% of the whole budget. The lion's share, i.e. around 75%, comes from the Gross National Income (GNI) contributions of Member States. Then, there are the Value Added Tax (VAT) based contributions, which account for 11% of the budget. This VAT resource is clearly not an EU tax as the percentage collected at the EU level is levied by Member States on the basis of their national VAT base. Moreover, the fact that this resource is subject to corrections in order to adjust for the different national payments makes it a *de facto* GNI resource.³ Thanks to these corrections, each country's payment is more or less proportional to its GNI. Therefore, around 86% of the EU budget is currently financed by national contributions. The remaining 1% comes from fines imposed on businesses that are in breach of competition law as well as taxes on EU staff salaries.

Going back to the early days of the European project, it is interesting to note that whereas the European Coal and Steel Community (ECSC) was financed entirely through a tax, i.e. a levy on the production of steel, and thus enjoyed total financial independence from the Member States, the then European Economic Community (EEC) was denied any such

² *Ibidem*.

³ I. Begg, *Rethinking How to Pay for Europe*, European Policy Analysis, Sieps, March 2010

financial independence and was funded exclusively by means of direct contributions from the Member States.

In 1970, it was decided that the EEC should “own” the Community’s revenues and a system of own resources was put into place. Revenue sources directly related to common European policies were therefore selected. These revenues – now known as “traditional own resources” (TORs) – are the proceeds from agricultural levies and customs duties.⁴ Member States retain 25% of these proceeds to compensate for their costs of collection. In the mid-1970s, these TORs accounted for about two-thirds of the EU budget. However, with the progressive reduction of tariffs and levies in world trade and the convergence of the EU prices for agricultural commodities with the world market prices, it rapidly became clear that this source could not ensure sufficient revenue.

Thus, in the late 1970s, the TORs were complemented with a VAT resource, which gradually became the main source of funding until the late 1990s. This VAT resource comes from a uniform percentage levied on a VAT-base calculated for each country (on the basis of a harmonised methodology). This national VAT-base is essentially statistical due to the complex calculations required in order to compensate for varying zero, reduced, and standard VAT rates among Member States. Moreover, in order to prevent less wealthy countries from having to pay a disproportionate amount due to the regressive nature of a VAT resource⁵, rules for limiting the VAT-base (“capping”) at 50% of GNI came into force in 1988. Initially set at 1% of the national VAT-base, the uniform percentage levied for the EU level has been modified several times until eventually being set at 0,3%. For the period of 2007-13, a reduced percentage was established for Austria, Germany, the Netherlands and Sweden as a means of giving them rebates.⁶ The proportion of the EU budget coming from VAT revenue declined from 57% to about 11% today.

However, with expenditure continuing to rise due in part to increased agricultural and cohesion spending, a resource based on Member State contributions, i.e. an equal percentage of each Member State’s GNI, was eventually established in 1988^{7, 8}. This GNI resource is conceived as a residual source which should balance revenue and expenditure. The size of the Member State GNI contributions depends on the expenditures foreseen in the budget as well as the revenue expected from alternative sources. Yet, as mentioned above, the overall size of the EU budget may not exceed 1,24% of all the Member States’

⁴ For a more detailed description of these TORs, see Article 2(1)(a) of Council Decision 2007/436/EC, Euratom of 7 June 2007 (ORD 2007); It should be noted that since the implementation into EU law of the Uruguay round agreements on multilateral trade, there is no more material difference between agricultural duties and customs duties. Hence, the Commission does no longer mention agricultural levies separately from customs duties.

⁵ A “regressive tax” is a tax that takes a larger percentage from low-income people than from high-income people. In the VAT case, consumption in less wealthy countries tends to make up a higher percentage of GNI.

⁶ Council Decision 2007/436/EC, Euratom of 7 June 2007 (ORD 2007)

⁷ A few years before, the GNI resource had already been introduced temporarily in the form of intergovernmental advances when the Community was unable to cover its expenses.

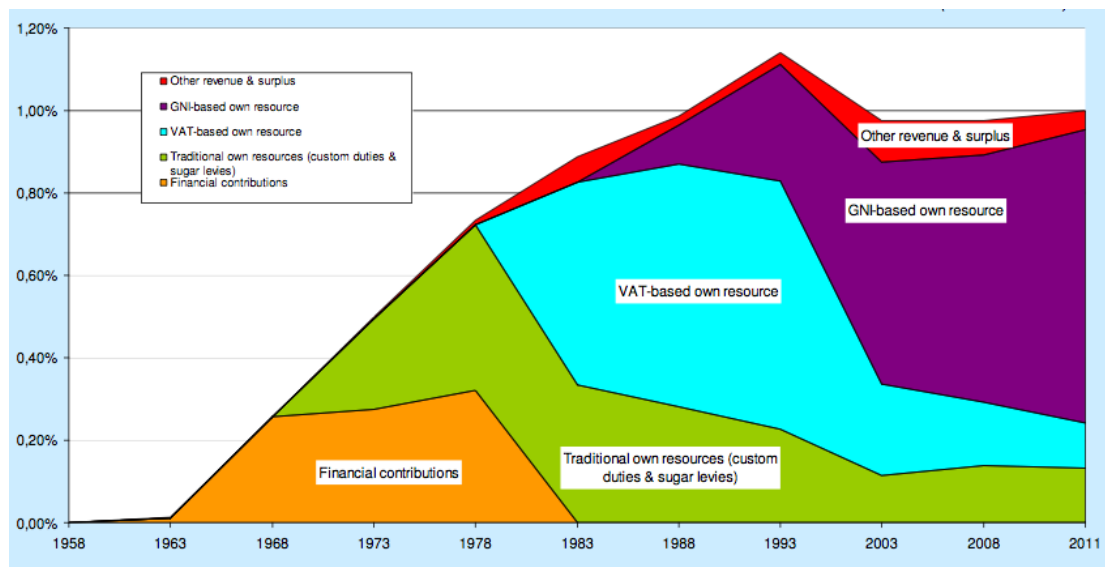
⁸ I. Begg, H. Enderlein, J. Le Cacheux and M. Mrak (2008), *Financing of the European Union budget*, Directorate General for Budget, European Commission, April 2008.

GNI. Notwithstanding its “residual” nature, the share of GNI contributions in the EU budget rose from less than 11% to around 75%.

Despite the fact that the relative weight of the four sources has changed dramatically, over time the financing of the EU budget has been more or less taken back to where it came from, i.e. national contributions based on economic size.

One can therefore wonder 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. As rightly stated by Ian Begg⁹, although 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 similar to inter-governmental transfers financed by the wide range of national taxes, rather than an identifiable single tax or other revenue that EU citizens can assimilate to the EU budget. Therefore, in opposition to the implications of the term “own resources” which includes national contributions, this paper will use the term “genuine own resources” to qualify resources that, in the spirit of the Treaty, are levied at the EU level.

Figure 1: EU budget revenue 1958-2011 (in % of EU GNI)



Source: European Commission, DG Budget

⁹ *Ibidem.*

1.2. The correction mechanisms and the *juste retour* polemic

EU spending is unevenly distributed among Member States, in a great extent due to some particular policies. For instance, the design of the Common Agricultural Policy favours some countries over others and the cohesion policy provides more resources to less affluent states. Since the adhesion of the UK to the EEC in 1973, the issue of the net balance, i.e. the difference between what a Member State pays into the EU budget and what it receives from it has become more and more significant. Throughout the years, the growing share of national contributions to the EU budget has increasingly facilitated an accounting logic of *juste retour*. This logic gave birth to the implementation of numerous correction mechanisms through political arrangements, making the system more and more complex.

In the early 1980s, the UK was clearly recognised as an important net contributor. By importing large volume of agricultural products from the rest of the world, it had to pay comparatively more in customs duties and, due to its small agricultural sector¹⁰, received only a low share of the EU budget. After various unsatisfactory deals to correct this inequitable situation, the UK was finally granted its famous rebate in 1984, allowing for it to be reimbursed 66% of the net imbalance. This correction mechanism consists in a reduction of the UK's VAT-base that is financed by all the Member States, in proportion to each country's share in VAT transfers. Also in 1984, Germany - as another important net contributor - was allowed to pay only a share of its normal contribution to the UK rebate. In 1999, three other countries, namely the Netherlands, Austria and Sweden, were also granted rebates on the normal costs paid by all Member States to the UK rebate. Contrary to the corrections granted to Germany, the Netherlands, Austria and Sweden, the British rebate is not a temporary correction. Since it has been introduced in the Own Resources Decision of 1984, it can only be modified by unanimity, which tends to give it a "permanent" character.

In 1999, it was also agreed that the percentages the Member States were allowed to retain as collection costs on the proceeds of the traditional own resources (TOR) would be increased from 10% to 25%. This percentage is often considered as particularly beneficial to the Netherlands and Belgium due to the fact that a significant share of the EU's imports from third countries goes through their ports. As such, these collection costs are regarded by some as hidden correction mechanisms. However, not only the percentage applies to all Member States, but also the amounts retained do not aim to correct excessive net positions of Member States as is the case with corrections. Indeed, the collection costs on the TOR are not taken into account when calculating the net positions of Member States.

In 2007, further corrections were introduced as part of the political agreement on the Multi-Annual Financial Framework (MFF) 2007-2013. A reduction in the rate of call on the VAT resource was granted once again to Austria (0,225%), Germany (0,15%), the Netherlands and Sweden (0,10%), compared to the rate of call of all other Member States, which was frozen at 0,3% of the national VAT-base. Furthermore, the Netherlands and Sweden obtained a

¹⁰ At that time, the Common Agricultural Policy represented around 70% of the EU budget.

gross reduction of respectively €605 and €150million on their GNI-based annual contributions. Finally, the 2007-2013 MFF includes a range of unexplained *ad hoc* special payments under the Structural Funds, including for example €200 million for Prague and €75 million for Bavaria.¹¹

Behind the argument of equity, the issue of the net budgetary balance is not well founded. There is a mistaken perception that net contributions mirror the geographical distribution of net benefits and costs from the EU budget.¹² The calculations are thus arbitrary on many grounds. Firstly, part of the EU expenditure in favour of programmes implemented in third States has a positive impact on participating European companies, although these costs are not included in the calculation of the net contribution. Secondly, the custom duties and agricultural levies (traditional own resources) are levied in the country where the import takes place while it is not always the country of destination of the product, which distorts the figures. Finally, and most importantly, the calculations of net balances fail to take into account the wider net benefits of the process of integration, particularly the participation to the single market. As rightly stated by Jutta Haug *et al.* (2011)¹³, “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”. As a result, rather than privileging the European public interest, Member States tend to focus on their own net financial balance, leading to a sub-optimal allocation of EU spending.

2. GENUINE OWN RESOURCES: NECESSARY BUT POLITICALLY DIFFICULT TO ADOPT

It has become apparent that what ought to be included in the concept of “own resources” has strongly evolved over time. Today, the EU’s own resources are largely composed of national contributions. Yet, when one speaks about “genuine own resources”, it is with the intent of returning to the spirit of the Treaty, which has always argued for the EU’s financial autonomy. As such, “genuine own resources” must be understood as resources that are levied at the European level, such as an EU tax. For a long time, there have been strong calls for a return to more genuine own resources. In order to better understand the stakes of the negotiations on the financing of the EU budget, it is important to firstly examine the positive elements of the current system before analysing why it is nevertheless necessary to move towards more genuine own resources.

The current system works fairly well. Although the increasing share of the GNI resource has incited the development of complex correction mechanisms, this resource has the great

¹¹ Council of the European Union, Financial perspective 2007-2013, CADREFIN 268, Brussels, 19 December 2005, pp. 17-20.

¹² I. Begg *et al.* (2008), *op. cit.* n° 8, p. 57–58; J. Le Cacheux (2007), *Funding the EU budget with a genuine own resource: the case for an European tax*, Notre Europe, p. 5.

¹³ J. Haug, A. Lamassoure, G. Verhofstadt, D. Gros, P. De Gauwe, G. Ricard-Nihoul and E. Rubio, *Europe for Growth – For a Radical Change in Financing the EU*, CEPS and Notre Europe, April 2011.

advantage of being simple and easy to administer. Its residual nature ensures that all planned expenditure will be financed by sufficient and stable revenue. By contrast, the yield of a particular EU tax can be unpredictable. Hence, in the case where the revenue of resources levied at the EU level would not be sufficient, the GNI resource would still be necessary as a residual income (though in a smaller extent) in order to balance the budget. Besides, if the revenue of (an) EU tax(es) came to exceed the expenditure, a way to return the money would need to be devised. Finally, the current system is relatively fair amongst Member States as each of them gives an equal proportion of its national income to the EU budget (horizontal fairness).

Despite the advantages of national contributions, there are several reasons in favour of a shift towards new genuine own resources. First of all, in a period of economic and financial crisis like today, the introduction of more genuine own resources would reduce the pressure on national budgets by diminishing the GNI contributions.

Moreover, many people believe that using genuine own resources such as an EU tax would be the only way to diminish the “poisonous” emphasis on *juste retour*.¹⁴ The current system of direct contributions from Member States highlights the amounts being transferred to the EU and induces governments to book these as expenditure items in their national budgets.¹⁵ It is clear that a tax levied at the EU level would not prevent Member States from calculating their own net contributions as the revenues of this resource would still be collected by national authorities and transferred to the EU. However, the collected funds would not be included in the national budgets and the net balances would be much more difficult to calculate due to the cross-boundary nature of an EU-tax. For instance, Member States tend to include the proceeds from custom duties and agricultural levies - considered as genuine own resources - in their calculations of the net budgetary balance. However, it has been explained above that these calculations tend to be incorrect due to the fact that the tax is not always levied in the country where the goods taxed are consumed. Consequently, a system of genuine own resources could shift the focus of the debate from the distribution of the tax burden among national budgets towards the more relevant question of the distribution among the different classes of citizens.¹⁶

This last observation is directly linked to the fact that the current system is arguably fair in the case of national contributions between Member States (horizontal fairness) but not between the different classes of citizens (vertical fairness). As national tax systems differ among Member States, EU citizens do not participate to national contributions for the EU budget according to their ability to pay, i.e. proportionally to their wealth. A shift towards more genuine own resources “might help to move the debates away from a limited and dubious conception of ‘horizontal fairness’ (based only on a purely accounting logic of ‘net

¹⁴ J. Le Cacheux, *Budget européen: le poison du juste retour*, Notre Europe, série “études et recherches”, No. 41, juin 2005; J. Haug *et al.* (2011), *op. cit.* n°13.

¹⁵ I. Begg *et al.* (2008), *op. cit.* n°8, p. 57-58.

¹⁶ *Ibidem*, p. 57.

national contributions') towards a well-founded discussions on horizontal and vertical fairness and efficiency considerations."¹⁷

Given the gap between the EU and its citizens, another argument in favour of genuine own resources is that they would help to increase the EU's legitimacy and accountability towards its citizens. Of course, such genuine own resources could also create the negative image of the EU imposing additional taxes. Yet, in reality, by levying resources at the EU level, the EU's funding would become more visible to citizens-taxpayers, de facto creating a closer connection and drawing them closer into the EU's expenditure-decisions.¹⁸

Finally, such a move could allow the EU's budget decision-making process to focus more on delivering public policies that conform to the EU public interest and individual citizens' preferences.¹⁹ A proposed EU tax could be directly linked to a specific EU policy, thus making genuine own resources more efficient in their contribution to the effective pursuit of European policy objectives.

It is clear that finding an agreement between the Member States on the introduction of more genuine own resources is difficult to reach politically. Not only do Member States fear a loss of sovereignty should they give up on taxing power, but any tax format levied at the EU level necessarily implies winners and losers. However, introducing more genuine own resources would bring the significant improvements mentioned here above while keeping most of the advantages of the current system. Indeed, the GNI-based resource could be largely replaced by genuine own resources but maintained as a residual resource to assure the balance of the EU budget. The EU would be financially more independent from Member States, implying an important political step towards more European integration.

3. THE PROPOSED EU FINANCING SYSTEM FOR THE MFF 2014-2020

In June 2011, the European Commission presented its proposal for the EU's next MFF 2014-2020.²⁰ The Commission proposed raising the EU 2014-2020 budget from the current €976 billion to €1,025 billion, representing a 4,8% increase. However, the negotiations have since then introduced significant changes relative to the Commission's proposal. In order to have the most accurate information, this paper will take the last proposal of European Council President Van Rompuy released during the summit in November 2012²¹ as a reference of the state of play of the negotiations. According to this document, the proposed level of the next

¹⁷ J. Haug *et al.* (2011), *op. cit.* n° 13.

¹⁸ *Ibidem*, p. 63.

¹⁹ *Ibidem*, p. 57.

²⁰ European Commission (2011), *Proposal for a Council Decision on the System of Own Resources of the European Union*, COM(2011) 510 final, Brussels, 29 June 2011, available on:

http://ec.europa.eu/budget/library/biblio/documents/fin_fw1420/proposal_council_own_resources_en.pdf

²¹ European Council (2012), Draft conclusions, SN 37/12, 22 November 2012, available on: <http://www.openeurope.org.uk/Content/Documents/Pdfs/HvR%20II.pdf>

MFF is now set at €972 billion, which is less than the current MFF level. This would represent 1,01% of EU GNI.

According to the Van Rompuy proposal, the reform of the EU financing system “should be guided by the overall objectives of simplicity, transparency and equity”. This proposal took over the Commission’s proposal, which for the first time decided to introduce new genuine own resources, a modification of the current correction mechanisms via a system of lump-sums and a reduction of the collection costs on the TOR’s proceeds.

The following sections will respectively analyse and see to what extent the Commission’s and the European Council President’s proposals on the revenue side would improve the current system by making it simpler, fairer and more transparent.

3.1. Introducing new genuine own resources

The proposal to introduce new genuine own resources implies a radical shift in the current structure of own resources. National contributions that currently account for 85.3% of the budget could be significantly reduced.²² In order to replace national contributions, new taxes would be levied at the EU level. Among other options, the Commission retained two new own resources (subsequently taken over by the European Council President), namely a Financial Transaction Tax (FTT) and a new VAT resource.

Although they have not been retained, the other options of EU taxes are worth being mentioned, as they remain very interesting options for future negotiations:

- A Financial Activities Tax;
- A tax on air transport;
- A share of the revenues of the auction of allowances from the Emissions Trading Scheme;
- An Energy Tax;
- An EU Corporate Income Tax.²³

In order to analyse the new VAT and the FTT as new genuine own resources of the EU budget, we have borrowed a comprehensive list of criteria established in a background study written by Begg, Enderlein, Le Cacheux and Mrak for DG Budget of the European Commission in 2008 (see figure 2).²⁴ These criteria are summarised in Figure 3. Each of them

²² According to the Commission’s proposal, national contributions could be reduced to 40,3% by 2020. However, this figure must be taken cautiously given that, as mentioned, the stakes of the negotiations have already changed.

²³ The Commission justifies why it has not retained the other options in the following document: European Commission (2011), *Financing the EU budget: Report on the operation of the own resources system. Accompanying the document Proposal for a Council Decision on the system of own resources of the European Union*, Commission Staff Working Paper, SEC(2011) 876 final/2, Brussels, 27 October 2011, available on: http://ec.europa.eu/budget/library/biblio/documents/fin_fwk1420/proposal_council_own_resources_annex_en.pdf

²⁴ I. Begg *et al.* (2008), *op. cit.* n°8.

can serve to assess the positive and negative sides of the proposed new own resources. It is clear that an "ideal resource" meeting all the criteria does not exist. The objective is thus to analyse each criterion in order to see where a potential new resource performs well or not. This should allow for an objective assessment prior to any shift in the way the EU is financed.²⁵

Figure 2: Criteria for assessing potential EU own resources

CRITERION		EXPLANATION
Economic consideration		Criteria that reflect analytic factors derived from economic theory
1.	Economic efficiency/distortion effects	Does the resource affect only some sectors of economic activity, with adverse (or, in the case of "Pigouvian" taxes, favourable) allocative effects?
2.	Vertical equity in promoting redistribution	Ability to pay at the level of the citizen
3.	Horizontal equity among equivalent citizens	Are individuals in similar circumstances treated equivalently?
4.	Fairness between Member States - GNI per capita	Ability to pay at the level of the Member State
5.	Fairness between Member States - appropriability of revenue	Does tax collection at the Member State level fail to reflect the true incidence of the tax among Member States?
Political and administrative factors		Criteria that are political in character or concern implementation
6.	Sufficiency of revenue	Does the resource raise enough revenue to cover all, or a sizeable proportion of the total needed?
7.	Stability of revenue source	Does the yield vary, e.g. Over the economic cycle?
8.	Other administrative considerations	Any other issues, such as susceptibility to evasion, collection costs, need for revenue sharing etc.?
9.	Link to EU policy concerns	How well does the proposed tax correspond to policy domains in which the EU is prominent?
10.	Visibility and transparency to tax-payers	Will individual taxpayers be more aware that they are contributing to the EU when paying the tax?
11.	Autonomy for the EU level of government	Is the resource genuinely 'owned' by the EU and where does 'the power to tax' effectively lie?

Source: Begg, Enderlein, Le Cacheux and Mrak (2008)

²⁵ *ibidem.*

The relative importance given to each of these criteria may or may not correspond to the views of the reader, but in the framework of the EU negotiations for the adoption of new own resources, some criteria are clearly more salient than others.

Iain Begg explains that behind each criterion, there are different interests at stake among the diverse actors of the policy-making process.²⁶ Autonomy, for instance, is a very contentious criterion. Most Member States are unwilling to part with their power to tax in favour of the EU level as they do not want to lose any sovereignty. Given that the EU Own Resources Decision requires unanimity in the Council of Ministers, the autonomy criterion may well act as a veto player against any EU level tax adoption process. Member States are also very concerned about the fairness criterion that reflects itself in the *juste retour* debate. Both the European Parliament and the Commission consider appropriate to link the way the EU is financed to the policies it pursues. The European Parliament also gives much importance to the transparency of the process and the Commission is very concerned about sufficiency and stability of revenue as it is the one in charge of the management of the EU budget. As for citizens, they are likely to be concerned by the equity criteria.

In a nutshell, this approach is an excellent means not only to assess what are the relevant criteria that a new resource should meet according to one's views, but also to analyse whether this resource has any chance of being adopted according to the main interests of the policy-makers.

3.1.1. A new VAT-based resource

The Commission proposed to abolish the current VAT-based resource and to replace it with a new own resource based on VAT as well. This is part of a broader revision of the future of VAT initiated by the Commission in order to fight VAT fraud, improve the administration of the tax and strengthen harmonisation of VAT systems across the EU. As such, the VAT-based resource is closely linked to EU policy via the objective of developing a European VAT policy in line with the completion of the internal market.

The idea is to allocate a share of the gains derived from this VAT reform to the EU budget. While the VAT-based resource accounted for 11,2% of revenue in the EU budget for 2011, the new VAT resources could account for 18.1%. Contrary to the Commission's proposal that foresaw the introduction of this new VAT by 1 January 2018 at the latest, the Van Rompuy document proposes to introduce it by 1 January 2021 at the latest. The postponement of the new VAT-based resource does not bode well for its future adoption.

The existing VAT-based resource was first implemented in the 1970s. However, since its inception it has faced considerable critique about several of its aspects. The most important one is that the resource is levied on a "virtual" harmonised VAT-base calculated by Member

²⁶ I. Begg (2011), *An EU Tax - Overdue Reform or Federalist Fantasy?*, Friedrich Ebert Stiftung, February 2011.

States, which is “complex to the point of incomprehensibility”.²⁷ The VAT-base is subjected to several adjustments in order to compensate for the varying zero, reduced, and standard rates between Member States. The resulting harmonised VAT-base may be subsequently capped (at 50% of GNI) and takes into account compensation arrangements for the UK. All these adjustments are designed to address differences in VAT implementation between Member States. Therefore, the current VAT method is perceived as a second GNI resource.

Because of the complexity of the calculations required by the VAT resource, the lack of transparency for citizens, and the high administrative costs for businesses, several experts²⁸ have come to support the abolition of the VAT as an own resource.

The new VAT method proposed by the Commission is based on a revenue transfer mechanism and can be explained in four main steps:

- The new VAT resource will continue to be based upon VAT receipts. However, in order to ensure that only VAT receipts are included, about half of the Member States will need to continue correcting their figures to exclude interest and penalties. Moreover, some Member States will also need to continue making some adjustments in order to take into account overseas territories, the specific VAT treatment granted to some peripheral regions and subsidies they deliver through the VAT system.²⁹
- The key element of the proposal is to use a uniform percentage of VAT receipts accruing from standard-rated supplies, i.e. goods and services, in every Member State. All the supplies subject to reduced or zero tax rates at the national level would be exempted. The uniform percentage removes the need for each Member State to compensate the effects of their own VAT taxation arrangements with those of the other Member States by providing a single ratio that can be used by all.³⁰ With this new system, much of the calculation efforts currently undertaken by Member States will move to the Commission. The latter will be mainly in charge of establishing the uniform percentage. That percentage would be valid for the period of a MFF.
- Member States will then apply the uniform percentage to their adjusted receipts. The resulting chargeable VAT receipts figure is converted to a tax-base value using each Member State’s actual VAT standard rate. The tax-base retained for the transfer towards the EU level will thus focus on the harmonisation that actually exists, i.e. the smallest common denominator of supplies at standard rates in all national VAT systems.

²⁷ European Court of Auditors (2008), *Response by of the European Court of Auditors to the Commission’s communication ‘Reforming the Budget, Changing Europe’*, April 2008, §26-28.

²⁸ F. Heinemann, P. Mohl and S. Osterloh (2008), *Reform Options for the EU Own Resources System*, Research Project 8/06, commissioned by the German Federal Ministry of Finance, January 2008.

²⁹ European Commission (2011), *Proposal for a Council regulation on the methods and procedure for making available the own resource based on the value added tax*, COM (2011) 737 final, Brussels, 9 November 2011.

³⁰ European Commission (2012), *Working Document of the Commission Services - The uniform percentage for the new VAT own resource, what it represents and how it will be established*, COMBUD 110/12, Brussels, 26 March 2012.

- National tax administrations will finally transfer a share of the chargeable VAT-base to the EU level. As stated in the proposal for the next MFF 2014-2020, this share would be set at 1% (not exceeding 2%) of the chargeable VAT-base.

According to the Commission, the revenue estimates (on the basis of 2009 data) could reach between €20,9 billion and €50,4 billion.³¹ The revenue estimates are dependent on the degree of harmonisation of the tax base, i.e. the common standard rated supplies.

Compared to the current system, not only does the new VAT resource reduce the number of corrections Member States need to apply to their VAT receipts, but it also eliminates the need to calculate compensations to the VAT-base. The method uses real data instead of forecast-based payments and year-end balance exercises.

The Commission has argued that the new system would radically simplify the current procedure, ensure equal treatment of taxpayers in all Member States, reduce the administrative burden for Member States, strengthen the link with EU VAT policy, and make the procedure more transparent and predictable.³² The following paragraphs will analyse the accuracy of these claims by assessing the new VAT resource using the criteria of Figure 3 mentioned above.

a. Economic considerations

With regard to the criterion of **economic efficiency/distortion effects**, the new proposed VAT will probably have a limited impact compared to the current system. In a Communication on VAT reform, the Commission has acknowledged that "Member States are understandably unwilling to take any risks that are triggered by reform efforts and could threaten VAT revenues, which accounted for around €784 billion in 2009".³³ Although it is anticipated that the new VAT-based resource would reduce Member States' revenues by providing more funds to the EU level than the current VAT-based resource, any such reduction would be offset accordingly by a reduction on the GNI-based resource. The new VAT resource will not really alter economic behaviour compared to the current situation regarding the fact that the various VAT rates among Member States will remain the same. However, the VAT is used by Member States as an instrument to change purchasing power. With the new system, it will not be possible anymore to transform standard rated supplies, which are subject to the uniform percentage, in reduced or zero rated supplies. This might reduce the distortions of competition in the internal market. Nevertheless, current national

³¹ European Commission (2011), *Financing the EU budget: Report on the operation of the own resources system*, op. cit. n°23.

³² European Commission (2011), *Proposal for a Council Regulation on the Methods and Procedure for Making Available the Own Resource based on the Value Added Tax*, op. cit. n°29.

³³ European Commission (2011), *Communication from the Commission to the European Parliament, the Council, and the European Economic and Social Committee on the future of VAT Towards a simpler, more robust and efficient VAT system tailored to the single market*, COM(2011) 851 final, Brussels, 6 December 2011.

VAT exemptions and to a lesser extent the use of reduced rates would still lead to important distortions of competition.³⁴

The VAT's **vertical equity or "ability to pay" principle among citizens** would not really change with the new VAT resource. VAT is a form of consumption tax and has a very large base. VAT affects all consumers in the same way. It is often considered as a regressive tax, meaning that the poor participate more, as a percentage of its income, than the rich. However, it can also be argued that wealthy citizens pay more in that they tend to consume more. In order to alleviate the regressive nature of the tax, reduced or zero rates on basic consumer goods and services are applied. However, the tax-base of the new system will not take into account the reduced and zero rated supplies but only the standard rated supplies.

Horizontal equity among citizens in different Member States will be improved. In the current system, the contributions of the citizens to the EU budget based on the VAT resource differ according to the country in which they reside.³⁵ The national differences in the zero, reduced, and standard rates demonstrate the non-harmonisation of the single market and the current need for compensations. However, with the new system, all the EU citizens that buy standard rated supplies included in the harmonised percentage will automatically contribute for around the same amount to the EU budget. Moreover, once a supply is comprised in the harmonised percentage of standard rated supplies, it will not be possible for it to become a zero or reduced-rated supply anymore. This would reduce slightly the redistributive effects of the tax on EU consumers.

The vertical fairness between Member States, characterised by their ability to pay, would be slightly improved by the new VAT but would nevertheless remain an important problem. Taking into account that the new VAT will be levied on the basis of a harmonised percentage of standard-rated supplies, the current system with the capping of the VAT base at 50% of Member States' GNI and many other corrections and adjustments to obtain a purely statistical VAT base would no longer be applied. However, as Gros and Micossi³⁶ have already shown, the VAT yields as a share of GDP and the private consumption as a share of GDP vary among Member States. In 2010, the receipts from the VAT across the 27 Member States ranged from 5.5% (Spain) to 9.9% (Denmark) of GDP³⁷, while the VAT-base expressed as private consumption varied from 37,2% (Luxembourg) to 75.9% (Greece) of GDP. As rightly explained by Begg *et al*³⁸, there is a correlation between the VAT rate and the tax income but it is far from linear. Moreover, the regressive nature of the VAT among Member States can also be partially refuted by the relatively high VAT income in some of the richer countries as well as among the poorer ones. All this leads to the observation that the

³⁴ Institute for Fiscal Studies *et al.* (2011), *A Retrospective Evaluation of Elements of the EU VAT System*, report commissioned by the European Commission, London, 1 December 2011.

³⁵ I. Begg *et al.* (2008), *op. cit.* n°8.

³⁶ D. Gros and S. Micossi (2005), *A Better Budget for the European Union: More Value for Money, More Money for Value*, CEPS Policy Brief No. 66, February 2005.

³⁷ Eurostat (2012), *Taxation Trend in the European Union: Data for the European Union Member States and Iceland and Norway*, 2012 edition, Luxembourg: Publications Office of the European Union, 2012, p. 186.

³⁸ I. Begg *et al.* (2008), *op. cit.* n°8, p. 83.

proposal of the Commission to transfer a share of a chargeable VAT-base to the EU level would also have an uneven incidence among Member States. Although the chargeable VAT-base would be relatively harmonised, the differences among Member States would remain important. Therefore, one can wonder with Begg *et al.*³⁹ whether adjustments could not be reintroduced in the future on the basis of the fairness among Member States argument.

As for **horizontal fairness among Member States** (i.e. the appropriability of revenue), the new VAT system will not fundamentally change the current situation. The VAT applies the “destination principle”, meaning that yields are raised in the Member State where the taxed product is sold. This means that exports are exempt and that imports are indirectly taxed. This can be seen as a substitution for tariffs within the customs union. The VAT can therefore be considered as “an instrument of intra-EU tax competition when used by one national government”⁴⁰. Moreover it can also be argued that the VAT paid by tourists on holidays increases the receipts of the hosting Member States, while reducing the VAT receipts of Member States where the tourists come from (the “Marbella effect”).⁴¹ Compared to the current system, the new VAT procedure will not take into account the reduced and zero-rated supplies in the calculations of the tax base anymore. Yet, it should not have a great deal of influence on the horizontal fairness among Member States.

b. Political and administrative factors

The new VAT has the potential to become a **sufficient revenue source** for the income side of the EU budget as long as there is a residual resource such as the GNI-based resource. The Commission’s proposal argues for an important increase of the funds coming from the VAT-based resource. While the current VAT-based resource accounts for € 14.5 billion (11.1% of total revenue), the minimum estimate of the new VAT-based resource in 2020 amounts to € 29.4 billion (18.1% of total revenue).⁴² In 2009, VAT across all EU Member States raised € 784 billion, or 6.6% of the EU’s GDP, while the EU budget accounts for around 1% of GDP. The potential revenue of the new VAT resource will depend on the uniform percentage, which has to be decided prior to the beginning of the new MFF.

The **revenue stability** of the new VAT resource should be guaranteed in the future. As the revenue source grows together with the economic cycle, an increase in the EU’s GNI will be reflected in VAT yields. Although we live in times of financial crises, where economic growth is no longer a certainty, an economic downturn will have less impact on VAT revenues compared to other types of taxation. The VAT is more stable than either an aviation tax or a financial transaction tax, which are more cyclical in their yield. This can be explained by the low revenue elasticity of the consumption goods and services subject to the VAT (although in general the EU’s standard-rated supplies are more elastic than zero- or reduced-rated

³⁹ *Ibidem*, p. 83.

⁴⁰ *Ibidem*, p. 83.

⁴¹ *Ibidem*, p. 64.

⁴² European Commission (2011), *Proposal for a Council Decision on the System of Own Resources of the European Union*, *op. cit.* n°20.

supplies). Moreover, the budget must be balanced, so even if the VAT resource goes down, it would be compensated by an increase of the GNI resource.

In terms of **other administrative considerations**, the new VAT would bring important advantages. The replacement of the current VAT-based resource, considered as the most controversial and complex own resource, by the new VAT resource would greatly simplify the contributions to the EU budget. The VAT resource would be no longer levied on a statistical tax-base requiring complex calculations. Instead, the new VAT resource would be calculated ex-post by allocating 1% of a partially harmonised VAT-base to the EU level. The uniform percentage of VAT receipts accruing from standard-rated supplies would also provide a high degree of predictability and certainty for Member States, as it would be valid for the period of a MFF. It would probably also decrease the incidence of tax evasion caused by horizontal tax competition, because the system would be more difficult to manipulate.⁴³ The simplification of the system should decrease administrative costs for national and EU administrations. However, the Commission specifies that “savings would only be obtained if there was no longer any need to calculate the uncapped VAT-base for the UK correction.”⁴⁴

The link to EU policy objectives, which characterised genuine own resources, would be more significant with the new VAT resource. Being a statistical construction, the VAT-based own resource only has a superficial link with the European VAT policy area. The current differences in rates and coverage exemplify the incomplete internal market, although there is a “passable degree of uniformity in the coverage of the tax”.⁴⁵ Member States are generally not in favour of harmonising the VAT for reasons of horizontal tax competition.⁴⁶ According to the Commission, the new VAT resource would provide “new impetus to the development of the internal market by reinforcing harmonisation of national VAT systems” via a uniform percentage of standard-rated supplies.⁴⁷ The new VAT resource will be directly impacted by both the European and national VAT policies. The entitlement to the EU budget will arise only when a Member State has actually collected the revenue from standard-rated supplies. This will create an automatic link between the national VAT receipts and the EU budget.⁴⁸

One of the motivations for creating a new genuine own resource is increased **visibility and transparency** for taxpayers. A new VAT-based resource would be an ideal way to create a link between the citizen and the EU and to make citizens aware of the costs of the EU.⁴⁹

⁴³ *Ibidem*.

⁴⁴ European Commission (2011), *Financing the EU budget: Report on the operation of the own resources system*, *op. cit.* n°23.

⁴⁵ I. Begg *et al.* (2008), *op. cit.* n°8, p. 83.

⁴⁶ A. Kölliker, A. (2001), “Bringing Together or Driving Apart the Union? Towards a Theory of Differentiated Integration”, in: *West European Politics*, 24:4, pp. 125–151.

⁴⁷ European Commission (2011), *Proposal for a Council Decision on the System of Own Resources of the European Union*, *op. cit.* n°20.

⁴⁸ European Commission (2011), *Proposal for a Council Regulation on the Methods and Procedure for Making Available the Own Resource based on the Value Added Tax*, *op. cit.* n°29, p. 4.

⁴⁹ P. Cattoir (2009), *Options for an EU Financing Reform*, Notre Europe, Policy Paper No. 38, December 2009, p. 33.

Instead of a system based on very complex calculations, the Commission proposes a simple system based on a direct transfer of a proportion of the receipts of a relatively harmonised VAT to the EU level. Electronic invoices could show the percentage of the VAT that goes to the EU revenue side, so that there would be a more direct and more apparent link between the citizens and the EU. Increased visibility would pave the way for more political accountability of the expenditure items.

The reform would clearly improve the **autonomy of the EU level of government**. The current VAT resource cannot be considered as a genuine own resource insofar as the establishment of its base and its rates remain Member States decisions.⁵⁰ Moreover, in order to ensure equity among Member States, the VAT resource is subject to various corrections and adjustments that make it comparable to a national contribution. In contrast, the new VAT would be genuinely linked to the EU level of government. Although revenue collection would still exclusively rely on Member States administrations, an automatic link between the national receipts stemming from a harmonised percentage of standard-rated supplies and the EU budget would be created. Therefore the VAT rates would still remain a Member State decision but the tax base retained for the transfer towards the EU level would be based on a harmonised percentage of standard-rated supplies. Given the differences between national VAT systems, the discussions on the degree of harmonisation of standard-rated supplies to establish the percentage are expected to be difficult.

c. Overall conclusions on the new VAT resource

The new VAT resource would not only bring many advantages compared to the current VAT-based resource but it would also represent a step forward in the EU integration process.

Under economic considerations, the impact of the new VAT resource on Member States will probably be limited relative to the system currently in place. The horizontal equity among citizens is likely to be slightly enhanced, as they will all pay around the same for the EU budget if they buy a standard-rated supply submitted to the uniform percentage. However, the new VAT resource would alter Member States' net balances, as most of the current compensations would be abolished. Member States could thus potentially call for new compensations based on the argument of vertical fairness.

Under political and administrative considerations, the new VAT resource would bring about many advantages justifying its status as a genuine own resource. The transfer of a share of the receipts to the EU level from a virtually harmonised tax-base composed of standard-rated supplies would create a genuine link between the national VAT systems and the EU budget. This would provide new impetus to the development of the internal market through an increased harmonisation of national VAT systems. The new VAT would also enhance the visibility and transparency for the sake of taxpayers. Moreover, the new VAT would improve the sufficiency of revenue, simplify the current procedure and, hence, reduce the administration costs.

⁵⁰ Although subject to some rules imposed at the EU level.

In the current state of the MFF negotiations, it remains to be seen whether the new VAT will be adopted. The Van Rompuy proposal has already postponed its implementation to January 2021 at the latest. Although the new VAT meets many of the evaluation criteria, Member States are sensitive to issues related to tax harmonisation as well as to their net balances. The UK, for instance, is against the adoption of a new VAT-based resource because it wants to protect its rebate, which is directly linked to the current VAT-based resource procedure.⁵¹

However, EU institutions and the Member States agree to a large extent that the current VAT system should be abolished. According to the Commission, the impact of eliminating the VAT-based own resource would not be significant. It would only slightly change the financing shares of Member States. Therefore, the earlier the old VAT-based resource would be replaced with the new one, the better it would be.

3.1.2. A Financial Transaction Tax-based resource

The most controversial part of the own resources proposal is undoubtedly the plan to introduce a tax on financial transactions. There is a strong feeling that the financial sector should contribute to bearing the costs of the crisis, mainly because of the extensive state support it has received (39% of EU-27 GDP in 2009),⁵² but also because of the subsequent budget cuts in nearly all EU Member States that have affected the everyday lives of citizens.

Such a Financial Transactions Tax (FTT) is not an entirely new idea. In the 1970s, James Tobin, a Nobel-prizewinning US economist, first proposed “throwing sand in the wheels” of the financial markets by imposing a tax on transactions. Since then, several countries introduced Tobin style levies on capital transactions.⁵³ Over the years, the financial sector has increased almost beyond imagination. Indeed, whereas in 1990 the annual turnover of financial transactions amounted to 15 times the world GDP, by 2008 this had risen to around 70 times global GDP.⁵⁴

The overarching goals of the FTT as proposed by the Commission are threefold.⁵⁵ Firstly, a FTT could ensure that the financial sector contributes more fairly to the society given the costs of the recent crisis and the under-taxation of the sector due to its VAT exemption. It is likely that the financial sector will at some point in the future again require public money. By putting in place a FTT, governments ensure that the financial sector itself contributes to such bailouts. Secondly, it would “create appropriate disincentives for transactions that do not enhance the efficiency of financial markets thereby complementing regulatory measures

⁵¹ House of Lords (2012), *The Multiannual Financial Framework from 2014*, 25 April 2012.

⁵² European Commission (2011), *Executive Summary of the Impact Assessment accompanying the document Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC*, SEC (2011) 1103 final, Brussels, 28 September 2011, p. 2.

⁵³ E.g. UK stamp duties on share purchases and other taxes and levies imposed on the financial sector following the financial crisis.

⁵⁴ S. Schulmeister (2009), *A General Financial Transaction Tax*, WIFO Working Papers 344/2009, October 2009.

⁵⁵ European Commission (2011), *Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC*, COM(2011) 594 final, Brussels, 28.9.2011, p. 2.

aimed at avoiding future crises”.⁵⁶ Thirdly, regarding the increasing amount of uncoordinated national tax measures on the financial sector being put in place in the aftermath of the financial crisis, an EU-wide FTT could avoid double taxation and distortions of competition in the internal market for financial services.

However, several Member States such as the UK (with its large financial sector) and Sweden have already challenged this third goal by stating clearly that they were against the adoption of such a tax. Consequently, at the request of eleven Member States⁵⁷, the Commission proposed a Council Decision authorising the adoption of a FTT under enhanced cooperation.⁵⁸ Other countries, such as the Netherlands, are considering joining the club. In his proposals on the MFF, European Council President Herman Van Rompuy maintained the idea of enhanced cooperation to adopt a FTT.

The Commission proposes an EU-wide tax rate of 0.1% on the exchange of bond and shares, and of 0.01% on derivative transactions between financial firms. Member States would remain free to impose higher tax rates. The FTT would be imposed on all transactions between financial institutions whether on the organised market or over the counter (OTC). Transactions involving private households or SMEs would mostly escape this tax.⁵⁹

A FTT is likely to raise significant revenues from the financial sector. Under the Commission and the European Council President proposals, two-thirds of the amounts collected by the participating Member States would be used as an own resource to finance the EU budget. The GNI-based resource of these Member States would be reduced correspondingly, leaving a lesser burden on national treasuries.

Although other options exist to tax the financial sector, such as a financial activities tax or a bank levy, the present paper will refrain from analysing them and will focus on the option retained by the Commission, i.e. the FTT. The latter will be assessed as a means to finance the EU budget on the basis of the criteria of table 3.

a. Economic Considerations

The **economic efficiency** of a FTT is subject to debate in the literature. The financial crisis lay bare the large systemic and contagion risks that are posed by financial transactions. The desirability and sustainability of the rapid and disproportionate growth of the financial sector compared to the real economy has been subject to strong doubts. A FTT cannot by itself correct undesirable market behaviour and thereby stabilising financial markets. However, it can contribute to it.

⁵⁶ *Ibidem*.

⁵⁷ Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia.

⁵⁸ European Commission (2012), *Proposal for a Council Decision authorising enhanced cooperation in the area of financial transaction tax*, COM (2012) 631 final/2, Brussels, October 2012.

⁵⁹ E.g. house mortgages, bank borrowing by SMEs, contributions to insurance contracts, spot currency exchange transactions, raising of capital by enterprises or public bodies, including public development banks through the issuance of bonds and shares on the primary market.

By means of what is called a Pigouvian tax, the government can tend to correct a market activity that generates negative externalities. High frequency trading is believed to have been a major market destabilising force.⁶⁰ A FTT would be directed to a large extent at automated trading systems, and particularly high frequency trading. These systems use to make very small margins, but on a very large volume of transactions. Therefore, even a small FTT would increase transaction costs and thus discourage potential traders. By reducing the volume of these high-risk financial transactions, a FTT would internalise the costs to society (in terms of systemic risk) into the price of financial transactions and thereby reducing speculation. According to the Commission, a FTT “would make financial markets more efficient, by steering them away from casino-type trading to more stable activities which support the real economy”.⁶¹

What remains unsure, however, is the extent to which the tax would discourage risky forms of trading on the financial markets. A FTT could contribute to reduce incentives for excessive risk-taking to the extent that short-term trading and highly leveraged derivative trading creates systemic risks.⁶² However, opponents of the FTT argue that by reducing trading volume, a FTT can in fact “distort pricing, since individual transactions will cause greater price swings and fluctuations”.⁶³ They also claim that transactions on which it would have the biggest impact are not necessarily the riskiest⁶⁴ and that banks and other financial institutions could use even riskier trading strategies to maintain their margins⁶⁵. The FTT is thus sometimes accused of being insufficiently targeted to reduce market-distorting speculation. However, when looking at the past, it is more likely that the banking sector will not become more risk averse because of a mere FTT. A FTT could play a significant stabilising role if “financial alchemy” banks, such as Goldman Sachs, were guided by more long-term trading and fewer overnight repurchase agreements”.⁶⁶ Nevertheless, the Commission itself recognises that regulatory measures more closely linked to the sources of systemic risks would be more appropriate to deal with undesirable market behaviours.⁶⁷

It is also broadly recognised that a FTT would not reduce the excessive leverage created by the different tax treatment of debt and equity. Asset bubbles are to a large extent caused by excessive leverage, not excessive transaction per se. Therefore, the issue would be better

⁶⁰ In terms of exchange rates, commodity prices, interest rates and stock prices over the short term as well as over the long term. “This is so because short-term price runs, strengthened by the use of automated trading systems, accumulate to long-term trends, bull markets and bear markets”; see interview with Stephan Schulmeister, *FTT will Dampen Speculation*, Euractiv, 20 July 2011, available on: <http://www.euractiv.com/euro-finance/economist-fft-dampen-speculation-interview-506656>.

⁶¹ European Commission (2012), *Commission proposes green light for enhanced cooperation on financial transactions tax*, Press Release, Brussels, 23 October 2012.

⁶² European Commission (2011), *op. cit.* n°52, p. 4-5.

⁶³ T. Beck and H. Huizinga (2011), *Taxing Banks — Here We Go Again!*, 25 October 2011, available online at <http://voxeu.org/index.php?q=node/7129>

⁶⁴ *Ibidem*; According to them, the FTT would not impact the riskiest forms of speculative trading: the Collateralised Debt Obligation (CDO) and the Credit Default Swap (CDS) markets.

⁶⁵ De Nederlandsche Bank (2011), *Financiële transactietaks in EU onwenselijk*, DNB Bulletin, 6 February 2012.

⁶⁶ M. Roe (2012), *Tobin Trouble*, Project Syndicate, 17 February 2012.

⁶⁷ European Commission (2011), *op. cit.* n°52, p. 5.

addressed via regulatory measures that target leverage, such as higher margin and collateral requirements.⁶⁸

A significant economic concern of the proposal for a FTT is the risk of geographical relocation of financial institutions to countries where they will not have to pay the tax. In Sweden, a FTT was enacted in January 1984 and abolished in April 1990 mainly due to the banking sector's relocation to surrounding countries, especially the UK. Moreover, given that the FTT will most likely be adopted under enhanced cooperation, it would run the risk of causing intra-European relocation of financial activities from participating to non-participating Member States.

To reduce the risk of relocation, the tax would apply to every transaction where one party has its tax residence within any of the participating Member States. Under this residence principle, transactions will be taxed as soon as a financial institution or trader that is based in one of the participating countries is involved, even if the transaction is carried out outside the FTT club. Therefore, if a participating country is trading with a financial counterparty established in a non-participating or third country, both parties to the transaction would pay their share of the tax in the participating country of residence or deemed residence. That is why even non-participating countries, such as the UK, are preoccupied by the trans-boundary effects of the tax. They are equally concerned about the cascade effect of the FTT under which some intermediate transactions are not exempt from the payment of the FTT.⁶⁹ Therefore, by taxing some intermediate transactions, the effective rate of the FTT could become higher than the one foreseen in the proposal.⁷⁰ Apart from the risk of relocation to non-participating or third countries, there is thus also the risk that foreign financial institutions will not want to make new investments in the participating Member States.

In order to offset the relocation effect, the end goal of the EU is to promote a FTT at the global level. Some forms of FTT have already been successfully introduced in several G20 countries such as South Korea, Brazil, India, and South Africa. Although there is "high-level political support for the introduction of such taxes, including at successive G20 meetings",⁷¹ it is highly unlikely that this will materialise in the near future as even at the EU level, all Member States do not all agree on the adoption of a FTT.

In sum, the macroeconomic impact of a FTT is uncertain, as it depends on several factors that are difficult to assess, such as the tax base, the impact of a FTT on the financing of new investment, the risk of relocation and the mitigating effects from the design of the proposal. The FTT is expected to have a small but non-trivial effect on growth. The reason for this negative effect is the increase in the cost of capital, as the taxed persons will try to pass the

⁶⁸ T. Matheson (2011), *Taxing Financial Transactions: Issues and Evidence*, IMF Working Paper, WP/11/54, p. 37.

⁶⁹ The Commission's proposal foresees that intermediate transactions of parties that act on behalf of another party are exempt from paying the tax.

⁷⁰ M. Bijlsma, M. Lever, J. Anthony and G. Zwart (2011), *An Evaluation of the Financial Transaction Tax*, CPB Background Document, 21 December 2011, p. 9.

⁷¹ I. Begg (2011), *op. cit.* n°26, p. 14.

tax through to their clients, and which then works as a financing constraint for new investment.⁷² According to the last assumptions of the Commission, the estimation of the possible deviation of GDP was established at -0,28% in the long run.⁷³ This means that (when assuming in the baseline an annual growth of 1.5%) in 2050, instead of being 81.4% above today's level, the European GDP would be 81.1% above today's level. However, in the long-term, a FTT could reduce undesirable risk-taking behaviour, and therefore the probability of future financial crises. These positive effects on future growth potentially outweigh the negative effects, although estimates crucially depend on economic assumptions.⁷⁴

Regarding the criterion of **vertical equity among citizens**, i.e. the ability to pay, the FTT has a progressive distributional effect. This implies that its impact increases proportionately with revenue due to the fact that higher revenue groups benefit more from the services provided by the financial sector. Private households or SMEs that hardly invest in financial markets will thus mostly escape this tax. As previously said, by introducing a FTT, one of the objectives of the Commission's proposal is "to ensure that financial institutions make a fair contribution to covering the costs of the recent crisis and to ensure a level playing field with other sectors from a taxation point of view".⁷⁵ Herein lie two points of attention. Firstly, will the financial sector not just pass on the costs of the FTT? Banks and pension funds argue that the burden may eventually have to be passed on to consumers in order for the financial sector to maintain its margins.⁷⁶ Yet, they will only partly be able to do so. The vast majority of the tax will be collected from short-term trading with high leverage, and these are predominantly conducted by hedge funds that are involved in high-frequency trading, investment banks and amateur traders, rather than "normal" consumers.⁷⁷ Pension funds and insurance companies will pay much less than short-term speculators.⁷⁸ Even if they wanted to, investment banks such as Morgan Stanley cannot pass on the bill to individual citizens. Secondly, the Commission argues that the financial sector is under-taxed on the whole, because it is exempt from VAT taxation. Introducing a tax on the financial sector to help support the EU and national budgets would hence seem an "equitable" source of revenue.

Under the principle of **horizontal equity among citizens**, individuals in similar circumstances should be treated equally. Yet, if the tax is introduced under enhanced cooperation in some countries, then the citizens of the participating countries would be treated differently in similar circumstances than the citizens in the non participating countries. However, among

⁷² European Commission (2011), *op. cit.* n°52, p. 6.

⁷³ European Commission (2012), *Technical Fiche – Macroeconomic Impacts*, n.d., available on : http://ec.europa.eu/taxation_customs/resources/documents/taxation/other_taxes/financial_sector/fact_sheet/macroeconomic-effects.pdf

⁷⁴ S. Griffith-Jones and A. Persaud (2011), *Financial Transaction Taxes*, study commissioned by the European Parliament, p. 2.

⁷⁵ European Commission (2011), *op. cit.* n°58, p. 2.

⁷⁶ C. Nederhof (2011), *Bankenbelasting pakt banken driebubbel*, Het Financieele Dagblad, 2 February 2012.

⁷⁷ S. Schulmeister (2011), *op. cit.* n°60.

⁷⁸ S. Griffith-Jones and A. Persaud (2011), *op. cit.* n°74, p. 13.

the citizens of the participating countries, horizontal equity would increase relative to purely national taxes.

With respect to **vertical fairness between Member States**, the tax incidence is mainly a derivative of the progressive distributional effect. Member States with a high GNI per capita will pay relatively more, because citizens that have higher savings will contribute more. However, if a Member State's share of the EU financial sector is larger than its share of EU GDP, it would pay relatively more to the EU budget with the new FTT resource than with the GNI resource in the current system. This might lead to questions about the *juste retour*.

Finally, the **horizontal fairness among Member States**, i.e. whether tax collection reflects the true tax incidence, raises two important issues. Firstly, a FTT adopted under enhanced cooperation would not contribute to horizontal equity between Member States, as the financial sector would be treated differently between the participating and non-participating Member States. This means running the risk of intra-EU relocation of businesses at the expense of a functioning internal market. The Commission is well aware of this danger. This is why it stated that, "given the extremely high mobility of most of the transactions to be potentially taxed, it is important to avoid distortions caused by tax rules conceived by Member States acting unilaterally. Indeed, a fragmentation of financial markets across activities and across borders can only be avoided (...) through action at the EU level".⁷⁹ On the other hand, among the countries participating to the enhanced cooperation, horizontal equity would increase. Secondly, participating Member States with large financial centres such as Frankfurt and Paris would evidently collect the highest yields. However, the technical design of the tax would help with mitigating this effect. By using the residence principle the degree of concentration of the tax revenue should be lower as the geographical distribution will depend on the place of establishment of the financial actors, independent from the location of the transactions. Therefore, non-participating or third countries that trade in the participating markets will also be subject to the FTT.

b. Political and administrative factors

A FTT could raise **sufficient** revenue to cover a proportion of the EU budget but additional revenue sources would still be necessary. There is a large uncertainty about the real revenue potential, given the number of unknown variables and assumptions in the estimations. According to the Commission, the FTT could raise up to € 81 billion per year in 2020, with € 54.2 billion that could be granted to the EU budget, i.e. around one-third of the annual EU budget.⁸⁰ If these figures can give an idea of the important revenue potential of a FTT, they are however no longer up to date as not all Member States will join a FTT. Although the 11 participating countries have not yet agreed on a common approach to the taxation, Oxfam

⁷⁹ European Commission (2011), *Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC*, COM(2011) 594 final, Brussels, 28.9.2011, p. 2.

⁸⁰ European Commission (2012), *The financial transaction tax will reduce Member States' GNI contributions to the EU budget by 50%*, Press Release, IP/12/300, 23 March 2012.

estimates that it could generate about €37 billion per year⁸¹, while the French European Affairs Minister reckons that it could raise more than €10 billion per year⁸².

The ability of a FTT to raise **stable revenue** for the EU budget over time is subject to doubts. Here too, it is difficult to assess how the variables - such as the economic cycles, the financial sector's possible relocation from the EU to third countries and the missed investments from companies that choose to move their headquarters to non-EU countries - will affect the stability of the resource in the long-term.

The **administrative considerations** mainly focus on the collection costs of the tax. As a FTT would be a new system, its implementation would require collection costs. However, these costs should not be excessive, as most transactions are carried out electronically and the tax can be collected electronically and at the source. If existing market infrastructures, such as trading platforms, trade repositories or clearing houses, can be used in an efficient manner, a FTT could be collected at less than 1% of revenue raised.⁸³ However, concerns have been raised that the tax might be circumvented to a certain extent.⁸⁴ A number of anti-evasion measures and administrative cooperation both at national and European level would therefore be needed to ensure a successful implementation of the tax.

The FTT has a direct **link to EU policy objectives**. Since the financial crisis erupted, the EU has been trying to reform the financial sector in order to reduce the risk of future crises. The FTT fits into this objective. Furthermore, in its FTT proposal, the Commission speaks about the goal "to avoid fragmentation in the internal market for financial services, bearing in mind the increasing number of uncoordinated national tax measures being put in place".⁸⁵ As discussed above, a tendency exists to under-tax the financial sector in order to attract more investment. For instance, Ireland has attracted a lot of foreign direct investment in recent decades because of its tax climate. This leads to competition among Member States within the EU, a situation known as horizontal tax competition. The fact that the FTT will most probably be adopted under enhanced cooperation will affect the objective to avoid fragmentation in the internal market. Nevertheless, even if implemented by some Member States, a FTT would lead to more mutual supervision of the financial sector. A broad FTT would provide a certain level playing field for financial institutions and businesses, as well as a coordinated approach that would reduce tax evasion.

⁸¹ P. Motin (2012), *Vote du Parlement Européen sur la TTF*, Oxfam France, 12 December 2012, available on: <http://www.oxfamfrance.org/Vote-du-Parlement-europeen-sur-la,1575>

⁸² EU business, *Financial transaction tax should bring in EUR 10 bn: France*, 23 October 2012, available on: <http://www.eubusiness.com/news-eu/finance-france.k7c>

⁸³ European Commission, *Technical Fiche – Tax Collection*, n.d., available on : http://ec.europa.eu/taxation_customs/resources/documents/taxation/other_taxes/financial_sector/fact_sheet/tax-collection.pdf

⁸⁴ Z. Darvas and J. Von Weizsäcker (2010), *Financial-Transaction Tax: Small is Beautiful*, Bruegel Policy Brief, Issue 2010/02, February 2010.

⁸⁵ Letter from President of the European Commission José Manuel Barroso to President of the European Council Herman Van Rompuy, 17 June 2011, available on: http://ec.europa.eu/commission_2010-2014/president/news/speeches-statements/pdf/20110621letter_mem_council_en.pdf.

The answer to the issue of the FTT's **visibility and transparency to taxpayers** is twofold. On the one hand, a FTT is not really visible because it targets financial institutions, not citizens. Its visibility to "the man in the street" is therefore limited. At the most, amateur traders would be aware of the tax. On the other hand, people who invest their savings in financial markets would be affected, especially if financial markets transfer the costs to their clients as many have suggested that they will do. Yet, if people use intermediaries such as banks or pension funds, they will probably not be aware that they are contributing.

The **autonomy of the EU level of government** would be increased. Although, the FTT would be collected by the Member States and transferred to the EU, a FTT resource would be considered as genuinely owned by the EU. The fact that Member States would collect the tax revenues would still allow them to calculate their net contributions. However, the cross-boundary nature of the FTT resource would make the calculations inaccurate and much more difficult to establish. Moreover, the uniform rates of the FTT and the share of the receipts that would go to the EU budget would be decided at the EU level.

c. Overall conclusions on a FTT

In the end, the adoption of a FTT under enhanced cooperation would be a strong political choice. Given that governments and European citizens have principally borne the cost of the economic crisis, opinion polls show that a vast majority of the European citizens is in favour of taxing the financial sector. The tax would raise important revenue, an advantage for national governments that have a hard time balancing their budgets. The question is whether the use of a share of this revenue to finance the EU budget will raise enough political clout.

In terms of economic considerations, the overall impact of the implementation of a FTT will depend on several factors that are difficult to assess; such as the tax base, the impact of a FTT on the financing of new investment, the risk of relocation and the FTT's ability to reduce the risk of financial crises. Nevertheless, a FTT would most likely reduce excessive and specific risk-taking, especially frequent short-term transactions by automated trading. The distributional implications of a FTT in terms of vertical equity are typically progressive in that it is taking more from those who have the ability to pay. However, there are two major issues in terms of horizontal equity. Not only much of the revenue would appear to be generated by participating countries hosting big financial centres, but also a FTT adopted under enhanced cooperation would keep fragmentation in the internal market for financial services. Different types of taxes for the financial sector in the EU would bring about more tax competition and a risk of relocation. It remains that a FTT under enhanced cooperation is better than nothing as it would harmonize to some extent financial taxation in the participating Member States. Moreover the risk of relocation would be mitigated by the residence principle according to which, it does not matter where a transaction is carried out but who the transaction partners are.

Under administrative and political considerations, the assessment of a FTT is globally positive, though it remains difficult to determine how difficult it would be to implement

under enhanced cooperation. Although the tax would not be able to guarantee the sufficiency and stability of revenue due to the influence of various economic factors on its yields, its revenue potential should not be underestimated. Moreover, the FTT would most certainly be complemented with the GNI based resource, which would insure the balance of the EU budget. The FTT should also not bring about important collection costs if good use is made of existing market infrastructures. Finally, the cross-boundary nature of the FTT, its direct link to EU policy objectives, and its relative visibility and accountability towards citizens would make it what can be considered as a genuine own resource of the EU.

3.2. Tackling the correction mechanisms

Many of the main encounters on the financing of the EU budget are about the correction mechanisms. This question represents thus a key element of the reform of the EU financing system on the basis of the principles of simplicity, transparency and equity between Member States. In this context, it is important to recall that equity cannot be measured only in terms of Member States' net budgetary balances. The calculations of net balances do not take into account the mutual benefits of the EU budget specifically and the EU process of integration in general. However, fair burden sharing between Member States with respect to net balances represents an essential component of the final political agreement on the MFF.⁸⁶

The Commission proposed a radical reform of the system of corrections respecting the principle of the 1984 Fontainebleau European Council that "any Member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time". According to this principle, equity requires that Member States do not sustain an "excessive" net balance in relation to their capacity to contribute as reflected by their relative prosperity. Therefore, correction mechanisms should reflect the ability to pay of Member States and be limited to the duration of the MFF. Indeed, corrections are directly linked to the structure of expenditure, which changes from one financial framework to another.

This principle has been applied in consecutive Own Resource Decisions. The problem is that the objective conditions underpinning the correction mechanisms have changed significantly over time but this evolution is not correctly applied in the current corrections system. This is particularly the case of the British rebate, which has no expiration date. At the time of its introduction the UK correction offered a solution to what was obviously an inequitable situation whereby one of the main contributors to the EU budget was one of the poorest Member States. However, the circumstances leading to this particular situation have clearly evolved since the introduction of the rebate in 1984, and the net contribution of the UK with respect to its relative wealth is no more in accordance with the budgetary burden of other Member States. The current system of corrections is therefore not equitable. Some Member States benefitting from corrections have a more favourable net position relative to other

⁸⁶ Cyprus Presidency of the Council of the EU, *Revenue side – Own resources system of the European Union – Corrections*, Presidency Issues Paper – Multiannual Financial Framework 2014-2020, 22 October 2012, p. 3.

Member States not benefitting from corrections with a similar or even lower level of prosperity.⁸⁷ Consequently, the overall level of corrections in the current MFF is too high.

The description of the current system of corrections made in section 1.2 also showed that this system is complex and non-transparent. This is particularly due to the fact that the method for calculating the British rebate and the corrections granted to Germany, Sweden, Austria and the Netherlands is based on a reduction in the rates of call on the current VAT-based resource. Therefore, the prolongation of the current system would not be feasible if the proposal of the Commission to abolish the current VAT-based resource is adopted.

In order to make the system more simple, transparent and equitable, the Commission proposes a lump-sums system that should replace all current existing correction mechanisms as of 1 January 2014. The countries with an “excessive” budgetary burden would receive corrections in the form of lump sum gross reductions in annual GNI-based contributions during the period 2014-2020. All Member States on the basis of their GNI-shares would finance these lump sums. This new system would be simple and transparent, thus making it more open to public and parliamentary scrutiny.⁸⁸ While it would apply only for the period of the MFF, it would also be more equitable and predictable than the current correction mechanisms.

In order to determine the countries that could face an “excessive” budgetary burden for the next MFF, the Commission related the Member States’ net contributions (operating net budgetary balances) to their relative national prosperity (GNI per capita in purchasing power standards). According to this method, four Member States - the United Kingdom, Germany, the Netherlands and Sweden - would face an excessive budgetary burden. However, some countries, including the UK, question the figures used by the Commission to determine the rankings of relative national prosperity and net budgetary balances.⁸⁹ For instance, with respect to relative prosperity, the UK disputes, *inter alia*, the fact that the Commission measures the Member States’ levels of prosperity in GNI per capita in purchasing power standards. According to the UK, since the contributions to the EU budget “are made in nominal terms (i.e. Euro) at market exchange rate, it is more appropriate to look at GNI per capita levels calculated on nominal exchange rates”.⁹⁰ This method would rank the UK eleventh instead of ninth (with the Commission’s method) out of twelve Member States on relative prosperity.

The United Kingdom, Germany, the Netherlands and Sweden would therefore receive temporary corrections under the lump sums system for the next MFF. However, the Van Rompuy proposal has already modified the Commission’s proposal by maintaining the British rebate and changing the figures of the lump sums system for the three other countries. Therefore, while the Commission proposed the following tentative figures: €2.5 billion for

⁸⁷ *Ibidem*, p. 4.

⁸⁸ European Commission (2011), *op. cit.* n°23.

⁸⁹ Letter from the UK Representation to the EU Brussels (Sir Jon Cunliffe) to the European Commission (Hervé Jouanjean), 21 November 2012.

⁹⁰ *Ibidem*.

Germany, €1.05 billion for the Netherlands, €350 million for Sweden and €3.6 billion for the UK, the Van Rompuy document proposes an increase of respectively €300 and €100 million for Germany and the Netherlands, a decrease of €25 million for Sweden, and the maintenance of the British rebate.

The lump-sums system proposed by the Commission would be politically difficult to adopt. The Van Rompuy proposal clearly shows that it is not an option for the UK to abandon its rebate. The budgetary negotiations could therefore end up with an agreement where the UK could potentially accept a higher EU budget (or another request it would not have initially agreed on) against the maintenance of its rebate. Moreover, given that the current VAT-based own resource is an essential data for calculating the UK correction, the debate on the elimination of the VAT resource is directly linked to the discussion on tackling the correction mechanisms. The direction of these two debates could thus influence each other in one-way or another.

3.3. Reducing the collection costs on the TOR's proceeds

The system for the collection of traditional own resources will remain unchanged. However, as explained in section 2.2., the percentage of collection costs retained on the proceeds of the TOR is often deemed higher than the actual collection costs supported by Member States. In order to address this issue, the Commission has proposed a reduction of the collection costs on the proceeds of the traditional own resources from 25% to 10% starting 1 January 2014. Yet, it is likely that the collection costs will not be lowered to 10% in the final agreement. The recent proposal from Mr Van Rompuy has suggested for Member States to retain 15% of the collection costs on the amounts collected by them. Moreover, an important reduction of the collection costs on the TOR's proceeds compared to the current amounts could be questioned for several reasons.

Firstly, the Commission has based its proposal on the grounds that the collection costs are a form of hidden correction mechanism. Yet, contrary to the rebates, all the EU Member States can retain the same rate on the proceeds from TOR as collection costs.

Secondly, the collection costs retained by the Member States do not aim to correct excessive net positions of Member States but to invest in both infrastructure and administrative services, thus improving trade flows from and to other Member States. In a Communication of December 2012 on the state of the customs union, the Commission highlights “the value added and fundamental importance of the services that the customs union provides as a foundation of growth, competitiveness and security of the Single Market and the European Union”.⁹¹ Acting as a “guardian of the internal market”, customs must deliver various services, including trade facilitation, law enforcement (related for example to public health, consumer protection, the environment and agriculture), supply chain security and the fight

⁹¹ European Commission, *Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the State of the Customs Union*, COM (2012) 791 final, Brussels, 21 December 2012.

against fraud.⁹² In accordance with this point of view, collection costs are to be understood in a broad sense to include all the customs related challenges, in particular facilitating trade and enforcing legislation to protect the security and safety of the EU. The costs and investment expenditure necessary to ensure these challenges differ between Member States according to the importance of their Union's points of entry. Reducing the collection costs too much might thus have a negative impact on the internal market. Several Member States, particularly in this time of public debt crisis, might be inclined to reduce investments in transport and customs services. The effects would be negative not only for Member State individually, but for the EU as a whole, given that these investments are crucial for "the growth, competitiveness and security of the Single Market and the European Union".⁹³

Thirdly, the Commission recognises that in the last decades the customs union's performance has faced new challenges. Some of these challenges stem from the increasing globalisation of trade, stricter and more detailed legislation, new business models and logistics, as well as globalisation of crime and other threats.⁹⁴ At a time where Member States need to do increasingly more with increasingly less, the proposal of the Commission to reduce by more than half the amounts retained by Member States on the proceeds of the TOR seems thus rather questionable.

Finally, a part of the collection costs can be seen as an insurance mechanism against future liabilities that might arise due to carrying out custom services on behalf of the EU. Member States are required to perform custom services in a sound manner. A Member State risks being fined if it fails to do so. For instance, the EU can hold a Member State liable if it fails to collect the customs duties or it is late in making them available to the EU budget.⁹⁵ Other claims may arise from a natural or a legal person when a Member State does not meet legislation related to customs. As Member States perform custom services on behalf of the EU, it can be argued that the EU should carry a part of the potential legal liability through the collection costs.

Unsurprisingly, all of these reasons have caused some Member States to contest the proposed reform. Retaining 25% of custom duties does not correspond with collection costs in a narrow sense. Yet, discussions on the matter should be careful about taking into account all the Member States' costs linked to customs (e.g. investments, services and potential liabilities). A more balanced approach should lead to a percentage of collection costs retained by the Member States that is deemed fair from the points of view of both the Member States and the EU.

⁹² *Ibidem.*

⁹³ *Ibidem.*

⁹⁴ *Ibidem.*

⁹⁵ See for example Case C-392/02 Commission v Denmark and Case C-460/01 Commission v the Netherlands.

CONCLUSION

According to the Commission's and Mr Van Rompuy's proposals, the reform of the EU financing system "should be guided by the overall objectives of simplicity, transparency and equity". However, the analysis of the different elements of the proposal has shown that it will not be easy to reach.

Finding an agreement on the introduction of more genuine own resources will be difficult to reach politically. Introducing more genuine own resources in the EU budget is nevertheless essential for several reasons. Beyond increasing the financial autonomy of the EU level of government as set out in the Treaty, it could potentially address the *juste retour* issue, increase visibility and accountability towards the EU citizens, and establish a direct link between the financing of the EU budget and EU policy domains, thereby contributing to the pursuit of EU policy objectives. Consequently, this would represent a significant political step towards more European integration.

It is illusory to believe that there could be an ideal own resource that could fulfil all the economic, political and administration considerations that the financing system of the EU has to reconcile. The present system, mainly composed of the GNI-based resource, is satisfactory in that it ensures the sufficiency and the stability of revenues while being relatively fair. However, it favours an accounting logic of *juste retour*, making the system increasingly complex while failing to take into account the wider net benefits of the process of integration. The proposal of introducing two new genuine own resources in the EU financing system would therefore improve the current system. It would combine the positive aspects of introducing more genuine own resources with the advantages of the current system. The GNI resource would be partially replaced by the new VAT resource and the FTT resource but maintained as a residual resource to assure the balance of the EU budget. The EU would therefore be financially more independent from Member States' national treasury. Yet, it remains to be seen how and when these new genuine own resources will be implemented.

With respect to the proposal of a **new VAT-based resource**, it is unlikely that it will be adopted for the next MFF as its implementation has already been postponed to January 2021 at the latest. Although this new genuine own resource would bring many advantages compared to the current VAT-based resource, Member States are sensitive to issues related to tax harmonisation as well as to their net balances. Economically, the impact of the new VAT resource would be limited, but the abolishment of the current complex compensations to the tax-base would alter Member States' net balances. Some Member States could thus potentially call for new compensations in the future. Regarding political and administrative considerations, the new VAT resource would greatly simplify the current procedure and create a genuine link between the national VAT systems and the EU budget. It would also make the system more transparent and predictable with limited administration costs.

Regarding the proposal for a **FTT-based resource**, even if it is adopted under enhanced cooperation, it is nothing but sure that the participating Member States will accept to use

the revenue of the tax as a means to finance the EU budget. Introducing a FTT under enhanced cooperation would be a political choice. Opinion polls show that a vast majority of the European public is in favour of taxing the financial sector. The tax could raise important revenue, an advantage for national governments that have a hard time balancing their budgets.

Economically, the overall impact of the implementation of a FTT will depend on several factors that are difficult to assess, such as the true incidence of the tax, the risk of relocation and the FTT's ability to reduce the risk of financial crises. Nevertheless, a FTT would most likely act as a deterrent for transactions that do not enhance the efficiency of financial markets. The distributional implications of a FTT in terms of vertical equity are typically progressive in that it is taking more from those who have the ability to pay. In terms of horizontal equity though, there are two major issues. Not only would much of the revenue would appear to be generated by participating countries hosting big financial centres, but a FTT adopted under enhanced cooperation would also keep fragmentation in the internal market for financial services. Yet, a FTT under enhanced cooperation would be better than nothing. Under administrative and political considerations, the assessment of a FTT is globally positive despite the fact that it remains difficult to determine how difficult it would be to implement under enhanced cooperation. Although the tax would not be able to guarantee the sufficiency and stability of revenue due to the influence of various economic factors on its yields, it has the potential for raising significant revenues. The FTT should also not bring about important collection costs if good use is made of existing market infrastructures. As a genuine own resource, a FTT would not only make it difficult for the participating Member States to accurately calculate their net contributions due to the cross-boundary nature of the tax, but it would also create a direct link to EU policy objectives and a relative transparency and accountability towards tax-payers.

With respect to the current **correction mechanisms**, it is already almost certain that the British rebate will be maintained for the next MFF. The introduction of a lump sums system for Germany, the Netherlands and Sweden would nevertheless create a more transparent, simple, accountable and fair system.

The reduction of the **collection costs on the proceeds of the traditional own resources** from 25% to 10% or even to 15% is questionable. It is clear that retaining 25% of custom duties as collection costs does not correspond to the actual collection costs incurred by each Member State. However, at a time where the customs union's performance faces new challenges linked to the increasing globalisation, the collection costs must be interpreted largely as including all the vital costs and investments aiming to improve trade flows, enforce law, and cover potential liabilities incurred by Member States on behalf of the EU. A balanced approach taking into account all these costs and investments must therefore be found.

Reforming the system of European own resources is possible, provided that there is enough political will. However, in a period of economic and financial crisis, the ambitious reform plans of the Commission for the next MFF have already provoked strong reactions from the Member States. The European Council President's proposal still represents a slight

improvement compared to the current system. The new VAT-based resource and the lump-sums system could clearly bring more “simplicity and transparency”. Yet, in the case where the FTT is adopted under enhanced cooperation and used as a means to finance the EU budget, it could potentially bring transparency but not simplicity to the own resources system. With respect to “equity”, the whole proposal, except the maintenance of the British rebate, should give rise to positive changes.

The final agreement for the next MFF will most likely bring marginal change from the status quo. It is indeed far from certain that new genuine own resources will be adopted and the most controversial correction mechanism, namely the British rebate, will probably remain. This reform has nevertheless the great advantage of putting the discussion about the necessity of more genuine own resources to finance the EU budget back on the table. It is very likely that this debate will resurface during the next revision of the MFF in 2020. Therefore, it would be interesting to re-examine other options of new genuine own resources, such as various forms of carbon tax.

Clémentine d’OULTREMONT is Research Fellow at EGMONT – The Royal Institute for International Relations

Arnout MIJS is Research Fellow at Clingendael – The Netherlands Institute of International Relations

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