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Financing the European Communities

Development of a European revenue system which would promote integration

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A. Problem and definition: European integration, European fiscal adjustment and the financing of the European Communities*

The problem of providing adequate finance for the tasks allotted to the European institutions arises regardless of what ideas are held about the concept and objectives of European integration. If the degree of integration achieved is to meet the conditions of a federal state, the tasks undertaken on a sovereign basis at the "European level" need adequate finance just as much as the tasks allocated at the supranational level if integration does not progress beyond the status quo. At all stages in the process of economic and political integration, therefore, there is a need for a rational revenue system, in which financing will be a dependent variable influenced by the degree of integration achieved at the time.

The converse can also be considered. The revenue system at European level has repercussions which may hamper or promote integration. On the one hand inadequate or non-existent financial autonomy at European level would do little to hasten the integration process. On the other hand the granting of greater autonomy with regard to revenue and the adoption of forms of financing likely to promote integration would produce an impetus towards integration. A European fiscal adjustment system may be regarded as a precondition for a European union going beyond the status quo and as an important support for the desired economic and monetary union. The mutual dependence between the financing of "Europe" and the attempts to unite Europe is the subject of this article, a theme which is often neglected in discussions of the prerequisites for a European economic and monetary union.

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We shall discuss concrete proposals for financing against this background of mutual interrelationships. As criteria are necessary for the assessment of these proposals, these notes are concerned mainly with the search for rules against which an economically appropriate revenue system for the European Communities may be judged.

In these notes it is assumed that a growing need for expenditure must be covered and that this problem cannot be solved simply by releasing the necessary funds by means of a different expenditure policy. We do not go into the question of whether this assumption that there is a given expenditure requirement, which may be considered in conjunction with the Popitz and Wagner law, is realistic or whether this development is desirable. The question of the methods and limits of greater integration, which can be answered in different ways from the economic and political points of view, will only be dealt with in passing insofar as it is linked with financing problems.

The proposed limitations relate to the areas of a European fiscal adjustment system within the framework of which the responsibilities for tasks, for expenditure and for revenue must be assigned to the existing levels. The financing of the European Communities is regarded primarily as a problem of vertical fiscal adjustment (or vertical apportionment of revenue). Responsibilities for tasks and for expenditure are discussed only if such discussion makes it easier to assess the different types of revenue found at European level[1]. Expenditure from the Community budget, with its

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1) An attempt to find a basis for the financing system in the historical parallels of the development of the Federal State of Germany or the American Federation of 1781 was largely ruled out. See C. Zellentin, "Budgetpolitik und Integration" (Budget Policy and Integration), "Finanzautonomie und Haushaltskontrolle in den Europäischen Gemeinschaften" (Financial autonomy and budgetary control in the European Communities), Cologne 1965, pp 49 et seqq, more particularly G. Schmölders, "Der deutsche Zollverein als historisches Vorbild einer wirtschaftlichen Integration in Europa" (The German Customs Union as a historical model for economic integration in Europe), "Aspects financiers et fiscaux de l'intégration économique internationale" (Financial and fiscal aspects of international economic integration), The Hague 1953 (Travaux de l'institut international de finances publiques - Transactions of the international institute of public finance), pp 137 et seqq, and C. Graf zu Stolberg-Wernigerode, "Geschichte der Vereinigten Staaten von Amerika" (History of the United States of America), Berlin 1965, p 35 et seq.

different methods of payment, for instance in the field of social and regional expenditure, is disregarded[1]. Although within the proposed definition this theme is part of the traditional subject matter of fiscal adjustment[2], it is - in the traditional treatment - only rarely examined from the supranational point of view[3] and has only very recently been investigated in relation to the concrete possibilities of financing the European Communities[4].

In the following notes a brief structuring of the problem precedes a search for economic grounds for assigning revenue jurisdiction to the "Fourth Level"; at the same time we examine, among other things, what knowledge can be acquired from an economic theory of federalism. The

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1) See F. Franzmeyer, B. Seidel, "Überstaatlicher Finanzausgleich und europäische Integration" (Supranational fiscal adjustment and European integration), Bonn 1976, pp 142 et seqq. By fiscal adjustment Franzmeyer and Seidel largely understand only European Community expenditure on regional development programmes (p 176 et seqq); in this connection see also the critique of the narrow concept by K. Schneider, "Überstaatlicher Finanzausgleich und Europäische Integration" (Supranational fiscal adjustment and European integration), Finanzarchiv, new series, Vol 36, 1977, p 343 et seq.

2) Popitz says: "Fiscal adjustment (therefore) relates to the state of most territorial authorities from the point of view of their actual and desired mutual financial relationships". J. Popitz, "Der künftige Finanzausgleich zwischen Reich, Ländern und Gemeinden" (Future fiscal adjustment between state, provinces and districts), Berlin 1932, p 1 et seq. And Rath says: "The raising of funds brings with it the problem of fiscal adjustment", W. Rath, "Europäischer Finanzausgleich" (European fiscal adjustment), 2nd edition, Göttingen 1953, p 5.

3) See W. Albers, "Steuer- und Finanzprobleme in einem Gemeinsamen Markt", (Problems of taxation and financing in a Common Market); W. Gerloff and F. Neumark (ed), "Handbuch der Finanzwissenschaft" (Manual of the Theory of Public Finance), Vol IV, 2nd edition, Tübingen 1965, pp 392 et seqq; T. Keller, "Finanzausgleich (I)" (Fiscal adjustment (I)), "Handwörterbuch der Sozialwissenschaften" (Concise Guide to the Social Sciences), Vol 3, Göttingen 1965, p 546 et seq; also the Tax Harmonization Report of the EEC Tax and Financial Committee (Neumark Committee), Brussels 1962, pp 65 et seq and K. Reding, "Zur Problematik eines Finanzausgleichs in der Europäischen Gemeinschaft" (The Problems of Fiscal Adjustment in the European Community), H.v.d. Groeben, H. Möller (ed), "Möglichkeiten und Grenzen einer Europäischen Union" (Opportunities and Limits of a European Union), Vol 2, Baden-Baden 1977, pp 203 et seqq.

4) See: Report of the Committee of Experts for examination of the function of public finances in European integration, Vol I, General Report, Brussels 1977, pp 71 et seqq and Vol II, "Einzelbeiträge und Arbeitsunterlagen" (Individual Papers and Working Documents), Brussels 1977, pp 520 et seqq, (referred to in the following as the MacDougall Group, Vol I or Vol II).

applicability of the criteria and principles of rational revenue or tax systems to Community revenue is examined before the arguments relating specifically to integration take the foreground. The central theme is "an approach to integration" in the context of which the integration process is analysed first as regards the effects of adjustment on the member countries and then in relation to its demands on future revenue from the standpoint of the new level which is being created.

Because of the importance to integration policy of the redistribution between the Member States, the revenue system must be regarded as a parameter of regional redistribution. In this context we get an analysis, with reference to revenue, of current financial relationships between the Community funds and member countries which often ends in an uncritical, "cameralistic" determination of the net flow of transfers between the Community funds and the member countries. While examining the significance of these analyses, the question arises of possible further-reaching research to determine the force of Community revenue for redistribution between the countries in the context of a "functional" approach[1]. The last section of this chapter contains a summary of the criteria for assessing the future form of the revenue system of a public sector for the Member States which is being expanded and/or restructured.

The last chapter contains comments on the continued development of the European revenue system in relation to integration; here concrete financing proposals are examined on the basis of the criteria developed in the preceding chapter and a new proposal is put forward for discussion. These considerations, based on selected financing

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1) On this distinction see W. Scheper, "Gesamtwirtschaftliche Umverteilungseffekte der Agrarpolitik" (Economic redistribution effects of agricultural policy), Paper for the Annual Conference of the Association for Social Policy, 1978, duplicated in manuscript form, p 11.

instruments, become more important because, under the current financing arrangements and with the number of Member States in 1979, the financial resources of the Community will be exhausted at latest at the beginning of the 1980s[1] and European integration will therefore reach its limits on the financial side[2]. For these reasons too "it is to be expected that the finances of the European Communities will become increasingly important"[3] [4].

B. The development of rules for assessing the financing of the European Communities

I. Three levels of approach to the problem of finance

A distinction should be made between three levels of approach to the problem of finance which has to be solved:

1) the assignment of revenue responsibilities to agencies;
2) the selection of types of revenue;
3) the definition of a European financial constitution in the context of integration.

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1) This statement is true even if we consider the budget forecast for the Communities (1979-1981); this is not based on a simple extrapolation of expenditure in 1973 but is associated with a more definite hypothesis having the object of curbing agricultural expenditure. Commission of the European Communities: Three-year financial forecast, 1979-1980-1981, Supplement to Volume 7, Individual Plan III, 1978, p 11.

2) For this reason at the end of November 1978 the Commission of the European Communities submitted to the Council and the European Parliament a memorandum concerned with possible ways of financing the Communities in the future and inviting the Member States to discuss the problem. See: Financing the Communities' Budget - future method, European Communities Bulletin, Annex 8/78.

3) H. Möller, European Community(ies) appears in "Handwörterbuch der Wirtschaftswissenschaft" (Concise Guide to Economics) (Manuscript p 63).

4) The Community budget is documented in Annex II; this will enable the reader who is less well informed about the present system of financing the Communities to familiarize himself with an analysis of the scope and structure of the Community budget as well as with the "own resources" system and "fund financing".

The different levels are intended to make it easier to assess existing theories, knowledge and attempts to find solutions in relation to the financing problem we have to analyse. If in what follows we examine what contribution can be made by the theory of federalism, a transfer of the criteria and principles of rational tax systems to the "Fourth Level" and a viewpoint geared to integration to the development of specific criteria for the assessment of a European revenue system, we must expect differences in the derivative rules of assessment against the background of the problem which has been outlined.

The first level of the problem appears when we enquire into the components of revenue autonomy and when there is an assignment of revenue responsibilities to levels. We might then look for economic reasons for greater centralization on the revenue side of a public sector the structure of which is changing. The concept of centralization or decentralization can be linked with the concept of a jurisdictional structure which in reality can be described on the basis of existing revenue adjustment systems and can be analysed according to the object and the exerciser of revenue jurisdiction. To the question, "Assignment to whom?" the answer is either to the Communities or to the Member States, and to the question "Assignment of what?" the answer usually takes the form, in the case of revenue, of a division between revenue-collecting jurisdiction, administrative jurisdiction and legislative jurisdiction ("object jurisdiction"), with the latter further subdivided into the power to fix tax rates and the right to determine the basis of assessment. In a profile of centralism, therefore, we find that fiscal adjustment arrangements tend to reflect revenue-raising autonomy. Diagram 1 shows the assignment problem in its basic form, no further differentiation being made between fiscal adjustment systems and the object[1].

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1) See particularly G.F. Break, "Intergovernmental Fiscal Relations in the United States", Washington DC 1967, Chapter 2, and F. Forte, "Grundsätze der Zuordnung öffentlicher ökonomischer Funktionen im Rahmen von Gebietskörperschaften" (Principles of assignment of public economic functions in the context of territorial authorities), MacDougall Group, Vol II, pp 369 et secq.

<u>Diagram 1</u>: Assignment of aspects of revenue jurisdiction to European Communities (EC) and Member States (MS) in vertical fiscal adjustment systems

Fiscal adjustment system / Aspect of jurisdiction	System of assignment "from the bottom upwards"		Mixed system				Divided system					
			Tax-sharing (tax pool)		Surcharge system		Earmarked				Not earmarked	
							Type and rate fixed		Type fixed, rate free			
	EC	MS	EC	MS	EC	MS	EC	MS	EC	MS	EC	MS
Legislative jurisdiction - over basis of assessment - over a share in the basis of assessment Jurisdiction over revenue-collection Jurisdiction over implementation	/Voir original/											

Apart from the question which aspects of revenue jurisdiction should be the concern of the Communities, we arrive at the second problem level which differs from the search for a suitable fiscal adjustment system in that concrete types of revenue are now sought[1]. Should the Community be financed by means of credits, charges and/or taxes and what connection is there in the different systems of vertical distribution of revenue between the funds accruing to the Community and the types of revenue? At this level it becomes clear that the integration of revenue is not necessarily a matter of allocating additional funds but rather of making a different allocation of the existing funds of all the Community countries.

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1) For this distinction see also W. Bickel, "Der Finanzausgleich" (Fiscal adjustment); W. Gerloff and F. Neumark (ed), "Handbuch der Finanzwissenschaft" (Manual of the Theory of Public Finance), Vol II, 2nd edition, Tübingen 1956, pp 744 et seq and p 749 et seq for the political aspect of fiscal adjustment, which is also emphasized here; see also H. Haller, "Die Steuern" (Taxes), 2nd edition, Tübingen 1971, § 2C.

The third and perhaps most important problem level is to be found in the connection between the degree of integration and the fiscal adjustment system. Vertical apportionment of revenue depends partly on the degree of integration; Customs Union, Common Market, Economic and Monetary Union and also a political union are characterized not least by different systems of fiscal adjustment because of different fiscal needs. The problem of a future European financial constitution can also be fitted into this integration relationship. On the way to economic and monetary union closer cooperation between the member countries and the Communities can be organized in different ways. Progressive integration demands common legislation in which the institutions of the Community will play a different part depending on whether we are working towards a federation or a confederation[1]. A more federal solution to the problem of a constitution for the Communities would include further development of the European Parliament so that it became an international chamber, whose decisions would be subject to the approval of the Council of Ministers, which might develop into a sort of Cabinet. The government of the Communities might emerge from the Commission. In the case of a confederal constitution for the Communities, as preferred by the French, government functions might be allotted to the European Council, for which no provision at all is made in the Community Treaties; the Councils of Ministers would become specialist cabinets and the Commission would cease to be an initiating institution and would become the administrative and implementing body. In this model the influence of the European Parliament would not increase, even as a result of the elections to be held in 1979. Finally, the financing of the Communities must also be considered in the political context of integration; the fiscal adjustment system will be determined by the political solution to the constitutional problem[2].

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1) In this connection see H. Schneider, W. Wessels (ed), "Auf dem Wege zur Europäischen Union? Diskussionsbeiträge zum Tindemans-Bericht" (On the way to European Union? Papers on the Tindemans Report), Bonn 1977, also "Europäische Union 1980" (European Union 1980), Bonn 1970, p 10 et seqq. And H. Oberreuter, "Kann der Parlamentarismus überleben? Bund - Länder - Europa" (Can Parliament survive? Federation - Countries - Europe)", 2nd edition, Zurich 1978, particularly p 74 et seqq.

2) See also G. Schmölders, "Finanzpolitik" (Financial Policy), 3rd edition, Berlin 1970, Chapter 2.

II. Economic reasons for assigning revenue jurisdiction to a higher level

There are two main objections to using the theory of federalism as the basis for designing a rational revenue system for the European Communities.

The first objection is that constitutionally the European Community is not a federation; at present it is a supranational association of sovereign states in the form of a "Common Market", with no uniform currency or laws, so that at best we can speak of embryonic federalism[1]. If we nevertheless attempt to cite arguments from the economic theory of federalism, it is because the main problem with this theory, ie the problem of assigning powers to "upper" and "lower" levels, also arises in connection with the European Communities' powers in relation to the revenue side of the Community budget. We therefore have to ask whether the arguments put forward for centralized and decentralized solutions to the problem of finance can supply any guide to the formation of a rational revenue system for the European Communities[2].

This formulation of the problem in itself raises the second objection to the application of the federalism theory to the revenue side of the Community budget. This is because, in attempts to solve the assignment of jurisdiction problem within a multi-level financial management system, public expenditure is in the foreground and revenue - with a few

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1) See M. Emerson, "The Finances of the European Community: A Case Study in Embryonic Fiscal Federalism", W.E. Oates (ed), "The Political Economy of Fiscal Federalism", Lexington, Mass 1977, p 129 et seqq.

2) For this economic view of federalism, see also W.E. Oates, "Fiscal Federalism", New York 1972, p 16 et seqq and G. Denton, "Finanzföderalismus und der Haushalt der Europäischen Gemeinschaften" (Fiscal federalism and the budget of the European Communities), Integration, No 1, 1979, p 11 et seq.

exceptions[1)] - tends to be handled on a classification basis in determining fiscal adjustment systems.

Against the background of the discussion on economic federalism, we may therefore examine whether (a) a greater degree of centralism on the revenue side is justified and (b) such justification is compatible with a specific allocation of revenue responsibilities at Community level.

The economic justification for more centralism on the revenue side will be examined briefly on the basis of the following arguments:

1) saving of costs in the collection of revenue,
2) financing on own responsibility,
3) supraregional tax effects,
4) avoidance of great regional variations in the yield from duty or tax[2)].

Savings of costs in the collection of revenue may occur where there is a higher degree of centralism if for technical reasons taxation and/or borrowing lead to a greater net fiscal yield. Where the distribution of responsibilities is the same, savings can be achieved by centralizing

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1) More or less on the principle of "Fiscal Equivalence"; see M. Olson, "The Principle of 'Fiscal Equivalence': The Division of Responsibilities among Different Levels of Government", The American Economic Review, Vol 59 (1969), p 479 et seqq; printed in German under the title "Das Prinzip 'fiskalischer Gleichheit': Die Aufteilung der Verantwortung zwischen verschiedenen Regierungsebenen", G. Kirsch (ed), "Föderalismus", Stuttgart 1977, pp 66 et seqq; see also R.L. Frey, "Zwischen Föderalismus und Zentralismus" (Between federalism and centralism), Berne 1977, pp 93 et seqq, and H. Hanusch, "Tendencies in Fiscal Federalism", H.C. Recktenwald (ed), "Secular Trends of the Public Sector, Proceedings of the 32nd Congress of the International Institute of Public Finance", Paris 1978, pp 129 et seqq.

2) See IV for the criteria of procedural policy; according to Bickel taxes should be subject to central control, "they depend on the state of the national economy as a whole or, conversely, have a determinant effect on it and are therefore particularly suitable as a regulating instrument". W. Bickel, "Der Finanzausgleich" (Fiscal Adjustment), W. Gerloff and F. Neumark (ed), "Handbuch der Finanzwissenschaft" (Manual of the Theory of Public Finance), Vol II, 2nd edition, loc cit, p 743; he also makes a distinction between economic, financial and political criteria; ibid, pp 748-751.

the administrative authority[1].

The principle that each level must finance its tasks on its own responsibility ("fiscal responsibility") leads to the revenue autonomy of all territorial authorities or levels and thus to the divided system. Related to the Communities it would mean a great measure of centralization, for as at the other levels, all powers would rest with the Communities[2]. This is now in some measure the case with customs duties and agricultural price-adjustment levies where we have an earmarked divided system.

The economic reasons for a great measure of fiscal responsibility at the different levels can be deduced from the link between the degree of autonomy and awareness of costs at government level. A large measure of fiscal responsibility creates better conditions for a more economical performance of tasks than a system of fiscal adjustment with less autonomy in which other bodies pay, in other words a form of cost reimbursement[3]. At Community level, a greater measure of fiscal responsibility in financing might well be a spur to the fulfilment of tasks more in line with need[4], which does not have to be guaranteed to the same extent in

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1) For general comments on the tax collection costs borne directly by the administration see F. Neumark, "Grundsätze gerechter und ökonomisch rationaler Steuerpolitik" (Principles of fair and economically rational tax policy), Tübingen 1970, p 372 et seqq, and with special reference to the costs in relation to levels, the figures given by W.E. Oates, "Finanz-Föderalismus in Theorie und Praxis; Lehren für die Europäische Gemeinschaft" (Fiscal federalism in theory and practice; lessons for the European Community), MacDougall Group, Vol II, p 320 and the literature cited there, also A. Breton, A. Scott, "The Economic Constitution of Federal States", Toronto 1978, p 106.

2) The greatest measure of centralization would occur if the European Community were to finance the lower levels within a system of grants "from the top downwards".

3) This "free-rider" thesis, which as regards private households is shown in relation to financing and "nil costs" in the statutory sickness insurance, is still more difficult to examine empirically in the case of political authorities, although experience of the Hospital Financing Law shows the connection between the refund of costs and the growth of expenditure. See Federal Government Report on the effects of the Hospital Financing Law, BTD 7/4530 dated 30 December 1975, p 3.

4) See D. Bös, "Effizienz des öffentlichen Sektors aus volkswirtschaftlicher Sicht" (The efficiency of the public sector from the point of view of the national economy), Schweizerische Zeitschrift für Volkswirtschaft und Statistik (Swiss Journal of Economics and Statistics), No 3, 1978, p 306 et seq.

the case of general grants from the lower levels which are typical of the financial contributions from the member countries to the Communities. There are limits to the wish for fiscal responsibility if the assessment bases are inadequate and therefore taxes have to be coordinated. These solutions do, however, permit of financing methods which would allow direct demands on the taxpayer.

In accordance with a demand which is frequently mentioned in regard to efficiency in allocation and is related to the free-rider problem, those who benefit from public services should be those who pay for them. This concept, like the demand for responsible financing,is based on the principle of "fiscal equivalence", which says that supraregional spillovers of benefits and costs should be avoided. This suggests that in the case of external effects reaching beyond the frontiers in the fulfilment of national tasks, supranational solutions may be necessary[1]. If taxation produces supraregional effects, it suggests that supraregional agreements may be necessary. There would then be cause on the revenue side for an "upward shift" of responsibility if, in the case of taxation, there had to be regional passing on of tax or "tax exporting"[2] and there was no compensating contrary influence on the expenditure side. A demand might therefore be that the jurisdiction for taxes with supraregional incidence should also be organized on a supraregional basis and various forms of horizontal and vertical tax coordination would have to be considered; such agreements require a more central division of authority than would

1) See MacDougall Group, Vol II, pp 379 et seqq and Vol I, pp 49 et seqq; in the latter passage (p 49) the "externality or spillover" criterion is applied, where certain policies cut right across all (or some) Member States and it would be impracticable or undesirable to make any attempt to limit these transnational effects or to control them at national level.

2) R. Peffekoven speaks of tax being exported "if the tax yield of a region (province, state, etc) exceeds the tax performance" ... and ... "part of the regional tax yield is not produced by the region itself". This situation leads to an expansion of the legislative authority and the revenue-collecting authority beyond their own frontiers. R. Peffekoven, "Zur Theorie des Steuerexports" (The theory of tax exports), Tübingen 1975, p 4 (quotations) and p 9.

be the case with taxes affecting a limited area[1]. This justification of greater centralization can also be underpinned for reasons of competition and it must be established in detail which of the powers within a revenue arrangement need central control in order to eliminate undesirable effects. If, for example, tax exports and imports cause taxpayers to migrate from one Member State to another, and if labour becomes undesirably mobile, the harmonization of the bases of assessment and rates of tax which is considered necessary can only be effected by means of supranational agreements; to this extent the harmonization of taxes always means a limitation of the national power to tax[2]. For example, in the case of taxation intended to avoid distortion of competition, the revenue-collection jurisdiction and administrative jurisdiction might be left "at the bottom" whereas the object of taxation, the taxpayer and/or the rate of tax could be determined "at the top"[3]. Regardless of the reasons behind the wish for

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1) In this connection Breton and Scott complain of the argument in the literature "that more coordination among jurisdictions would always be better than less, that is, because it (ie the literature, the author) implicitly assumes that the costs of coordination are zero, its treatment of the assignment problem is systematically biassed towards excessive investment in coordination and in harmonization", A. Breton, A. Scott, "The Economic Constitution of Federal States", loc cit, p 107. This statement at the same time presents a further justification of fiscal responsibility in financing and disengagement of the financing jurisdictions.

2) As regards taxes relating to products and factors, see N. Andel et al, "Bericht der Facharbeitsgruppe Steuerharmonisierung" (Report of the Working Party on tax harmonization), H. v.d. Groeben, H. Möller (ed), "Möglichkeiten und Grenzen einer Europäischen Union" (Opportunities and limits of a European Union), Vol 3: "Transnationale Kooperation, Steuerharmonisierung" (Transnational cooperation, tax harmonization), Baden-Baden 1976, pp 75 et seqq and pp 85 et seqq, also D. Pohmer, "Zum Grenzausgleich bei der Umsatzsteuer" (Cross-frontier equalization related to turnover tax), P. Bohley, G. Tolkemitt (ed): "Wirtschaftswissenschaft als Grundlage staatlichen Handelns" (Economics as the basis of government action), dedicated to Heinz Haller on his 65th birthday, Tübingen 1979, p 249 et seqq.

3) In this connection Dosser thinks there is a potential for centralization because in his opinion demarcation of the economic sectors of national taxes becomes more difficult with increasing economic integration and this may produce tasks for the European Community which can be accomplished by means of a Community budget. D.G.M. Dosser, "Überlegungen zu einigen finanzwirtschaftlichen Fragen im Zusammenhang mit der Wirtschaftsunion" (Some financing problems considered in conjunction with the Economic Union), Commission of the European Communities, "Economic and Monetary Union" group of experts, European Economic Integration and Monetary Union, Brussels 1973, C-III, p 73; a thesis by W. Albers, which relates more to the potential of decentralization, reads: "that those taxes in the case of which differences in application and form cause the smallest change in competition may be left within the competence of the member countries, harmonization being partially waived". W. Albers, "Steuer- und Finanzprobleme in einem Gemeinsamen Markt" (Tax and finance problems in a Common Market), Handbuch der Finanzwissenschaft (Manual of the Theory of Public Finance), Vol IV, 2nd edition, loc cit, p 393.

fiscal equivalence, knowledge of the regional incidence of taxation is one of the basic factors for decisions on centralization[1].

There is another reason for centralization if we consider regional differences in tax revenue. Revenue from customs duties, which for geographical reasons can only be collected at certain places (frontiers with third countries, ports) or which for unforeseen reasons (eg strikes) accrues in one country rather than another, tends properly to belong to umbrella territorial authorities, as such fortuitous circumstances will only exceptionally be matched by an equal expenditure requirement in the region concerned. Even within a customs union, in which the country collecting the customs duty is not necessarily the country of destination, there is a need for resources to be redistributed centrally, or for the revenue-collection jurisdiction to be centralized. There are similar reasons for a central revenue authority when the regional distribution of tax revenues fluctuates a great deal even though the use made of tax opportunities is comparable and this situation cannot be attributed to any given tasks specific to the region. The more one-sided a regional tax profile, the more likely it is that this difference has little to do with expenditure requirements and if special influences, eg the burden of the costs of congestion, are considered, there seems to be a case for a more central revenue-collecting authority[2] or some other umbrella financing

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1) See R. Peffekoven, "Internationale Finanzordnung" (International financial management), H. Gröner, A. Schüller (ed), "Internationale Wirtschaftsordnung" (International economic management), Stuttgart, New York 1978, p 123 et seqq, ibid, "Zur Theorie des Steuerexports" (The theory of tax exports), loc cit, p 26 et seqq.

2) The example of tobacco duty demonstrates that decentralized revenue-collecting power would be of little use. Let us assume that tobacco producers are greatly concentrated regionally and that they have to pass on all tobacco duty, which is payable everywhere, to the revenue authorities; in the absence of supraregional management of the revenue from the duty it would be arbitrarily distributed. See S.J. Mushkin, "Distribution of Federal Taxes among the States", National Tax Journal, Vol 9 (1956), pp 148 et seqq, and Ch. McLure, "The Interstate Exporting of State and Local Taxes: Estimates for 1962", National Tax Journal, 23 (1970), pp 206 et seqq.

arrangement (eg horizontal fiscal adjustment).

On the above arguments, economic reasons could be found for a greater degree of centralization on the revenue side[1]. If no such economic justification had been possible[2], greater autonomy of revenue in the Community could only have been underpinned politically. Whereas with revenue autonomy savings of costs can be achieved simply by shifting the administrative powers to a higher level, in the case of the other justifications the revenue-collection and legislative powers also have to be centralized. Except for the demand for fiscal responsibility in financing, the two other criteria fail to produce any specific conclusions about an acceptable fiscal adjustment system or about concrete types of revenue to finance the Community budget[3]. To this extent the "federalistic approach" is found to be only partially able to produce concrete revenue for the Community budget[4].

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1) F. Neumark draws attention to a "tendency for the relative importance of (central) government taxation to increase" and refers to an "age-old trend towards centralization of taxation", which on the one hand he regards as a consequence of the allocation of tasks to different levels and on the other hand accounts for on fiscal-political grounds. As evidence Neumark cites the Federal revenue from taxes as a proportion of the total tax yield. See F. Neumark, "Grundsätze gerechter und ökonomisch rationaler Steuerpolitik" (Principles of fair and economically rational tax policy), loc cit, pp 10-12; quotations pp 10 and 11. See also M. Neumann, "Comments", H.C. Recktenwald (ed), Secular trends of the Public Sector, loc cit, pp 160 et seqq, also D.G. Davies, "International Comparisons of Tax Structures in Federal and Unitary Countries", The Australian National University, Centre for Research on Federal Financial Relations, Research Monograph No 16, Canberra 1976. A distribution of the tax yield according to levels of powers in federations and unitary states will be found in the Table, Annex 1.

2) See also R.A. Musgrave, P.B. Musgrave, L. Kullmer, "Die öffentlichen Finanzen in Theorie und Praxis" (Public finance in theory and practice), Vol 4, Tübingen 1978, p 157.

3) In this connection see R.L. Frey, "Zwischen Föderalismus und Zentralismus", (Between federalism and centralism), loc cit, pp 93 et seqq; here value-added tax, excise duties, customs duties and the taxation of businesses are all regarded as federal taxes; taxes imposed as a matter of procedural policy and the scope-defining laws for the taxation of natural persons also come within the competence of the Federation. Finally, after redistribution, market-like revenue is not regarded as belonging to any particular level.

4) The thesis put forward by R.L. Frey in connection with the Swiss Federation according to which there should be greater centralization on the revenue side than on the expenditure side, could not be analysed in detail for the European Communities because the subject was too limited; as regards the developing level of the Communities, the author seems to think the opposite is more convincing. Ibid, p 97.

III. The applicability of the criteria and principles of rational tax systems to the European Communities

We find further useful information if we examine the adoption of criteria used to assess existing tax or revenue systems. On the one hand there are the general tax principles and on the other the special demands made on revenue systems by local authorities.

If a large measure of autonomy (earmarked divided system) is demanded for future financing at European level, and if it is also assumed - also unrealistic at present - that as regards its aims and scope the European budget is comparable with the national budgets at federal level and fulfils the traditional tasks of allocation, distribution and stabilization, taxation principles could be used to assess the types of tax. This stipulation is necessary because in fiscal adjustment systems with a low level of autonomy for the Communities direct recourse to the taxpayer is out of the question and in the grant system, for example, in the European Communities we have financing by contribution rather than by taxation. It would therefore be premature, especially at present, to adopt the criteria of a rational tax system at European level. It is more important to analyse the specific demands made of a European revenue system (see IV). This is done on the supposition that they do not on the whole coincide with the general principles of taxation and may even be in conflict with them[1].

Independently of the discussion on economic federalism and the approaches of political science experts to a theory of political integration[2] there is, particularly in the German-language countries, an intensive

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1) Such conflicts may also occur in a comparison between the general criteria of rational tax policy and the special requirements of local government tax systems.

2) See J.J. Hesse (ed), "Politikverflechtung im föderativen Staat" (Political integration in the federal state), Baden-Baden 1978; F.W. Scharpf, B. Reissert, F. Schnabel (ed), "Politikverflechtung II, Kritik und Berichte aus der Praxis" (Political integration II, Critique and Reports from practical experience), Kronberg 1977.

conflict with the features of a rational local government revenue system. This discussion might be turned round on the assumption that arguments which are "anti-low level" tend to be "pro-high level" and vice versa. This would produce a kind of "reversed local revenue system" for the Communities. A count of the taxes which, according to the criteria named in the literature, are found to be useless as local taxes (for instance, progressive income tax, property tax, special excise duties or trade and land taxes with progressive rates)[1], does indded bring evidence of their suitability for financing central government in a federal state, but not of their special suitability for financing European tasks. And as regards the reversal of the criteria for appropriate local taxes, it is doubtful whether it is unreservedly useful[2]. In accordance with a reversal of this type Community revenue should have the following characteristics:

1) that the equivalence principle is not applied;
2) that the taxes are unnoticed or not felt;
3) elasticity of yield of <1.

Whereas these inversions will not stand up to examination[3], a different situation arises if local taxes are required to show the smallest

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1) See H. Timm, "Gemeindefinanzen I, Theorie" (Local Government Finances I, Theory), Handwörterbuch der Sozialwissenschaften (Concise Guide to the Social Sciences), Vol 4, Göttingen 1965, p 299 et seqq; G. Seiler, "Ziele und Mittel des kommunalen Finanzausgleichs, Referat für den Finanzwissenschaftlichen Ausschuss des Vereins für Socialpolitik" (Objects and resources of the communal fiscal adjustment, Paper for the Committee of the Sociopolitical Association on the theory of public finance) 1978, duplicated in manuscript form, pp 55 et seqq; K. Littmann, "Die Gestaltung des kommunalen Finanzsystems unter raumordnungspolitischen Gesichtspunkten" (The organization of the local government financing system from the point of view of planning policy), Hanover 1968.

2) On the subject of the criteria which follow see the Expert Opinion dated 16 March 1968 on the local tax system and local tax reform in the Federal Republic of Germany,"Der Wissenschaftliche Beirat beim Bundesministerium der Finanzen: Entschliessungen, Stellungnahmen und Gutachten 1949-1973" (Economic Advisory Council to the Federal Ministry of Finance: Resolutions, comments and expert opinions 1949-1973), Tübingen 1974, pp 406 et seqq.

3) If we only think of local equivalence by groups in the context of local government, it certainly cannot be applied on a European scale.

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possible differences in yield per head within local authority areas of the same size. The inversion of this view provides justification for the centralization of taxation which has already been important in the discussions of centralism. If the economic activity underlying taxation is very unevenly dispersed, the autonomous use of this revenue by the area where the assets are located cannot be justified on the grounds of the equivalence theory nor can it gain approval as regards the passing on of taxes to the region. Greater centralism in one form or another would be indicated, but a European system would only be indicated if the two situations referred to assumed "European proportions". Even the wish for less sensitivity in local taxes to the cyclical economic situation could be applied inversely to the European level, but only if this was required to exert influence on cyclical trends. Thus the "inverse attitude" is only useful in some cases and even then cannot always be applied at Community level but only serves as a negative demarcation.

IV. Criteria specific to integration

1. Integration of revenue from the point of view of the Member States of the European Communities

1.1 Problems of adjustment for Member States in the financing of the European Communities

The following remarks are based on the assumption that a European revenue system has special features which we can deduce from the integration context. The special features of an integration-oriented revenue system are derived from the objectives of integration and the associated tasks of the Community budget.

As regards the financing of the Communities the process of integration can also be seen as a progressive willingness of the member countries to renounce their national sovereignty. The national waiver of revenues produces effects which we often fail to analyse in spite of their significance for the progress of European integration. The effects of a greater degree of centralization on the Member States must, however, be implicated, particularly in regard to the assessment which has to be made of proposals for a future revenue system. The following problems of adjustment will be singled out:

1) limitation of the rights of the national parliament;
2) the effects of federalism within the State (fiscal adjustment within the State made more difficult);
3) limitation of flexibility of national taxation;
4) effects on readiness to pay and willingness to integrate;
5) need for harmonization.

In analysing these repercussions, which arise simply from the handing over of national revenues to the Communities, the distinction between financing by "communalization" and financing by means of "additional resources" is important because national sovereignty is affected in different ways depending on whether the budget of the Communities is financed at the expense of national budgets or in addition to the national budgets. In the first case expenditure and revenue are passed on "upwards". Whereas the taxpayer is not directly affected when finance is provided by communalization, in the case of the second alternative he has to make additional contributions towards the Community budget. In the face of these two choices a pessimistic view of national sovereignty might be that the parliaments of the member countries agree to an increase in the Community government share[1] and thus increase the burden on the taxpayer rather than that they renounce national rights in favour of passing tasks and the provision of finance on upwards. This hypothesis can also be considered in conjunction with the importance of the European Parliament which can be changed by means of direct elections. It is therefore not impossible that in the long term this parliament, in conjunction with

1) The Community government share can be interpreted as the quotient of the expenditure of the Community and the national product of the Community.

the various countries, will be able to reach decisions about the revenue side of the Community budget. Whether parliamentarians in the European Parliament will agree to a federal system rather than to a surcharge or divided system remains to be seen; the former assumes greater coordination between the member countries and a bigger sacrifice of national revenue autonomy than a fiscal adjustment system which permits of additions to national taxes (partial legislative jurisdiction) or a still higher revenue jurisdiction. This could induce a momentum towards greater revenue autonomy which would leave national rights largely untouched[1].

The alternatives of communalization and supplementary financing are the subject of decisions by each Member State itself in the internal process of adaptation to the increasing financial needs of the Communities. If all the "rationalization reserves" of the Member States are exhausted they must either change the national rates of tax, bases of assessment or exemption limits or cut their expenditure programmes. The national federalistic structure and the arguments on fiscal adjustment are bound to be affected by the outcome and it is likely that the smaller territorial authorities will endeavour to pass the burden of adjustment to the federal authority or central government having regard to the traditional responsibility of central government for foreign policy. Conversely, the Federal Government will refer to regional accruals and benefits from the Community budget and try to persuade the provinces and/or districts to share in the financing or will force them to participate. The greater the financial burden, the more difficult national adjustment will be[2]. These problems would be intensified if Community revenue arrangements were made which had a direct effect on the national division of revenue between the territorial authorities, as would be the case in the Federal Republic of Germany if value-added tax were used to any great extent to finance the Communities. It would therefore be favourable to the development of a European revenue system if, other things being equal, a form of revenue were selected which would

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1) For the problem, linked with this subject, of the effects of a supranational tax authority on the relationship between tax and credit financing in the member countries, see H. Giersch (ed), "Fiskalpolitik und Globalsteuerung" (Fiscal policy and overall control), Tübingen 1973, pp 133 and 137.

2) See discussion in "Die Zeit", No 29 of 8 July 1977, No 30 of 15 July 1977 and No 31 of 22 July 1977, between H. Apel, Federal Minister of Finance, W. Leisler Kiep, Land Minister of Finance and M. Rommel, Oberbürgermeister.

have the least possible effect on the federal structures of the Member States.

But the problems of adjustment go further than this. Limitations on national expenditure or losses of revenue not only have fiscal effects on the federal system, they have non-fiscal effects as well. National autonomy suffers from any harmonization of bases of assessment, exemption limits, tax rates, etc, and problems arise particularly if national opportunities for action are lost in consequence and the use made of this potential at supranational level is either nil or not in accordance with the national way of thinking. For example, if large proportions of the revenue from indirect taxes (revenue-collecting jurisdiction) pass to the "Fourth level", these funds can no longer be used at national level under procedural policy. If the Community fails to take over a corresponding function in procedural policy there may be a transfer of the public finances remaining to the country with a wide variety of requirements[1] which, incidentally, may make harmonization even more difficult if it becomes necessary at a later date. In regard to the European revenue system, we might therefore require that the choice of one of several financing systems should, other things being equal, involve the least possible limitation of national tax flexibility[2].

The above argument can be refined if the attitude to adjustment in the integration process is classified by net recipient and net donor countries. The recipient attitude includes a voluntary or forced

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1) In this connection F.K. Mann, in his postscript to the reprint of his "Steuerpolitischen Ideale" (Ideals in the matter of tax), Stuttgart 1978, makes fresh reference to "putting financial policy on an economic basis" and also mentions "dissipation of the effects of taxes", p 365 et seq.

2) For the problems of implementing Community regulations in the Federal Republic and the Länder, see Final Report of the Commission of Inquiry into Constitutional Reform, BTD (Federal Government publication) 7/5924 of 9 December 1976, pp 146 et seq.

integration-oriented attitude on the one hand but on the other a relaxation of effort; a planned tax increase will not be imposed because the extra payment "from the top" makes it unnecessary. The effects of these "bonuses" at the European level produce difficult problems in the analysis of efficiency[1] comparable with those arising from the effective use and monitoring of national programmes of regional and economic policies. Net donor countries bear the financial burden; these countries will therefore only agree to additional taxes, thus giving a further impulse towards integration, if a comprehensive cost-benefit analysis of the advantages and disadvantages of greater integration produces evidence to show effects which will over-compensate the position of the net donor ("paymaster"). The burden of net payments is therefore the price to be paid for the advantages it is hoped integration will bring[2]. Over and above this the "paymasters" often try to stipulate the conditions for the receipt of payments or to make their willingness to pay dependent on the ability to exert such influence.

The last problem of adjustment is the need for harmonization in all its multifarious forms. For instance, the value-added tax regulations[3] assumed that this tax was levied in all the member countries. Then there was a need for harmonization in the establishment of a common basis of assessment by the Community and finally the tedious and still unfinished adjustment in the national turnover tax legislation. Types of revenue, which by comparison need little harmonization or relate to bases of assessment which have already been harmonized, exert little influence against integration, other things being equal. In this respect taxing the gross national product or taxing final consumption as under value-added tax is at first sight relatively simple, as a

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1) See primarily R.P. Nathan, A.D. Manvel, E.E. Calkins, "Monitoring Revenue Sharing", Washington DC 1975 and E.M. Gramlich, "Intergovernmental Grants: A Review of the Empirical Literature", W.E. Oates (ed), The Political Economy of Fiscal Federalism, Toronto 1977, pp 219 et seqq. Also C. Smekal, "Zwischenstaatliche Transfers (ZT) - Ziele und Ausgestaltungsprobleme" (Intergovernmental transfers - Objectives and problems of form), Paper for the Committee of the Sociopolitical Association on the theory of public finance, 1978, duplicated in manuscript form, pp 29 et seqq.

2) The proposed argumentation is applicable not only to the overall picture but also to types of expenditure, such as agricultural expenditure, under the Community budget.

3) See Documentation on the Community Budget (Annex II), pp 5 et seqq.

calculation of the common national product is available at the Statistics Office of the European Community and harmonization of the basis of assessment of value-added tax including its passage into national tax law is nearing completion. By comparison with taxes on value, taxes on quantity are also suitable, probably because they seem to need less harmonization as a type of revenue. Such simple solutions are superior in their political practicability and the time they take to implement[1], though the criterion of political practicability also includes problems arising from the need to ratify revenue measures. Here, at least in theory, the direct European elections make it possible for ratification to be legitimized direct by the enlarged European Parliament instead of by all nine separate parliaments. At first this would, of course, need the agreement of the separate parliaments and thus a lasting renunciation of sovereignty by the member countries.

1.2 Claims on revenue from the point of view of the European Community

A new level in the structure of the public sector has to perform tasks which change in the course of time with differing degrees of autonomy. It could therefore be in the interests of the "Fourth Level" always to ensure that its finances have the qualities of instruments to ensure their purposive use in the long term[2]. If the Community budget grows at a rate which produces repercussions in Europe, there will be very varied demands under procedural policy on the formation of European finances[3].

1) This is not to say that harmonization of direct taxes is not an important means of promoting integration.

2) For features of the use of unearmarked public finances as an instrument see H. Zimmermann, "Instrumente der Finanzpolitik" (Instruments of Financial Policy), Handbuch der Finanzwissenschaft (Manual of the Theory of Public Finance), 3rd edition, in collaboration with K. Andel and H. Haller, edited by F. Neumark, Tübingen 1977, pp 172 et seqq.

3) For principles of tax distribution under procedural policy see J. Hinnendahl, "Die Steuerverteilung zwischen Bund und Ländern in der Bundesrepublik Deutschland" (The distribution of taxes between the Federal Government and the Länder in the Federal Republic of Germany), Baden-Baden 1974, pp 41 et seqq.

In the context of the effects on economic development in the regions of Europe, increasing importance might attach to a European finance policy related to sectors and trades as well as to the regions. This is true particularly if problems of this sort increase in importance with the integration process and supranational action is economically effective[1]. If in the course of its growth the Community budget is also required to perform a stabilizing function to be put into effect on the basis of taxation of demand, deficit spending and thus progressive borrowing autonomy of the Communities will become necessary[2].

In regard to future Community revenues there will also be a demand that competition should not be affected. If, as is usually the case, this is considered in relation to the taxation of international trade and, in the context of "not affecting outside competition" and similar subjects, is related to tax-induced changes in competitiveness in goods traffic between Member States and with reference to international factor income, the aspect of harmonization of taxes in the Common Market has to be disregarded. From the point of view of financing, the harmonization of the bases of assessment at low levels of autonomy in the Communities appears more as a technical prerequisite for obtaining revenues[3]. If, in the course of the integration process, revenue autonomy went beyond existing taxes and if the Communities were to be given jurisdiction

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1) For the connection between Community budget and employment policy see T. Peeters, "Stabilitätsorientierte Finanzpolitik in der Gemeinschaft sowie Währungs- und Wechselkurspolitik" (Financial policy with the object of stability in the Community, also currency and exchange-rate policy), MacDougall Group, Vol II, pp 486 et seqq.

2) For the determination of tasks of the Community budget under procedural policy see W.E. Oates "Finanzföderalismus in Theorie und Praxis: Lehren für die europäische Gemeinschaft" (Fiscal Federalism in Theory and Practice: Lessons for the European Community), MacDougall Group, Vol II, pp 294 et seqq and pp 307 et seqq, and "Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung, Jahresgutachten 1972/73" (Board of Experts for the Assessment of Overall Economic Trends, Annual Report 1972/73), Section No 22 et seqq.

3) For the relationship between the objectives of tax harmonization and of financing the Community Budget see also A. Prest, Fiscal Issues, G. Denton (ed), Economic and Monetary Union in Europe, London 1974, p 90 et seq.

over the setting of tax rates and bases of assessment or even a right to impose a new tax (right of tax determination), the general requirements under the "principle of avoiding undesired detriment to competition as a result of taxation" could be considered[1]. The competition argument therefore gains importance in the case of a surcharge and/or earmarked divided system.

A point in dispute is the importance of whether a type of revenue is perceived (its "perceptibility") as an element promoting integration and as a criterion for assessing a European system of revenue. "Perceived involvement of the taxpayer" could be achieved by suitably planned tax supplements, say as a disclosed charge in the case of indirect taxes or as an announced supplement on income tax. Perceptibility has disadvantages if it has an adverse effect on awareness of Europe and if an implied or actual earmarking of Community taxes exacerbates discontent with government. Perceptibility could nevertheless, on the grounds given in the literature[2], be regarded as a secondary factor in the revenue system[3], its importance increasing - as in the competition argument - with growing revenue autonomy of the Communities.

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1) See F. Neumark, "Grundsätze gerechter und ökonomisch rationaler Steuerpolitik" (Principles of fair and economically rational tax policy), loc cit, pp 266-282 and the literature referred to there, also for assessment of the effects of government activity on competitiveness, I. Metze, "Steuerharmonisierung in einer Wirtschaftsgemeinschaft" (Tax harmonization in an economic community), Hamburg 1969, pp 31 et seqq.

2) See F. Neumark, "Grundsätze gerechter und ökonomisch rationaler Steuerpolitik" (Principles of fair and economically rational tax policy), loc cit, pp 37 et seqq.

3) If perceptibility is to be used as an instrument of integration, we could apply the experience of the fiscal psychologists. It would be their job to develop types of revenue which show identity and create an awareness of Europe and solidarity across the frontiers. National variations in tax honesty have also been studied by fiscal psychologists; as regards the development of European revenue, for example, the consequence of such variations is that where rates of tax and bases of assessment are harmonized, the yield from the national product will differ in relation to the tax honesty of the different nations. We will not consider whether this situation should be accepted as a regional characteristic or whether a remedy should be sought in the interests of justice and integration. In the case of a European revenue system this situation could be avoided by basing assessments on national product statistics. See K.-H. Hansmeyer, K. Mackscheidt, "Finanzpsychologie" (Fiscal Psychology), Handbuch der Finanzwissenschaft (Manual of the Theory of Public Finance) 3rd edition, in collaboration with N. Andel and H. Haller published by F. Neumark, loc cit, pp 566 et seqq, and the literature referred to there.

2. Integration-oriented determinants of financing

2.1 Integration objective and financing the Community budget

The importance of the revenue system for integration can be analysed on the one hand by looking into the causes of the standstill in integration of recent years and on the other by isolating the conditions for a political union in accordance with different theories of integration. The link with the revenue system is found if the causes of the breakdown in integration can be removed by certain revenue arrangements or if the stages leading to an economic and political union can be passed more rapidly by means of suitable financing[1]. At the same time it is recognized that financing instruments to promote integration can make only a small contribution towards uniting Europe. Very probably the European tasks or expenditure play a more important part in the long run than revenue, not to mention the political will of the Member States and the many small advances towards integration which are being accomplished by way of non-budget-effective changes in the integration structure. As, however, situations can be imagined in which revenue regulations can have adverse effects on integration and, moreover, an analysis of financing a "Fourth Level" includes the effects of this on the jurisdictional levels of the member countries, revenue is by no means a factor to be disregarded in the context of integration.

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1) The importance of financing the Communities for integration, and this can vary in the course of time, is also determined by the desired or attained degree of integration. On the basic opportunities for development of the Community see H. v.d. Groeben, "Die Europäische Gemeinschaft zwischen Föderation und Nationalstaat" (The European Community between federation and nation), v.d. Groeben, Boeckh, Thiesing (ed), Handbuch für Europäische Wirtschaft (Manual for the European economy), No 151, October 1977, pp 1 et seqq.

As regards the causes of the standstill in integration[1], it is difficult to find a link with the development of the revenue system. If, however, the cause of lack of success of integration intentions is "seen in the inadequate concept of what an economic and monetary union is and what conditions must be fulfilled for it to be created and to function"[2], links with the revenue system can be found in conjunction with the prerequisites and determinants of further economic integration. There is, however, no agreement on the weighting of the criteria, as they depend on the basic integration theories and the degree of integration desired. It is therefore conceivable that specific financing systems could be developed for the different integration theories and for the degree of integration desired.

From the relationship between the revenue system and integration let us now pick out interregional redistribution as one of the prerequisites for an economic and monetary union. Politically, redistribution can be justified above all by reference to regional differences in living standards[3] and to the Treaty of Rome (Preamble and Article 2 of the Treaty of Rome). Economically, it can be considered in relation to balance of payment problems which may lead to intervention under regional policy if changes in rates of exchange fail as a corrective. "Where there are great structural differences ... premature fixing of rates of exchange within the Community would exacerbate existing tensions and reduce the chances of mutual convergence of the economies linked in

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1) See W. Harbrecht, "Die Europäische Gemeinschaft" (The European Community), Stuttgart, New York 1978, pp 190 et seqq.

2) Report of the Study Group, "Wirtschafts- und Währungsunion 1980" (Economic and Monetary Union), Marjolin-Bericht, Brussels 1975, p 3.

3) For a statistical picture of the disparities in income and living standards, see MacDougall Group, Vol I, p 29, also F. Franzmeyer, B. Seidel, "Überstaatlicher Finanzausgleich und europäische Integration" (Supranational fiscal adjustment and European integration), loc cit, Annex 2, pp 233 et seqq, also Table 4 on pp 44 et seqq; for a justification of inter-state redistribution see also U. Everling, "Ausgleich der wirtschaftlichen und sozialen Unterschiede in der EG" (Adjusting economic and social differences in the European Community), Die Bank (The Bank), No 12, 1978, pp 567 et seqq.

the Community unless massive financial transfers were made to approximate the structural bases of the economies to one another"[1]. Depending on whether this financial safeguarding of an economic and monetary union is found to be adequate in theory and on whether it would be politically feasible from the point of view of the flow of finance required, integration could be accelerated or the degree of integration attained could be consolidated[2].

The power to redistribute wealth among the regions resting with a revenue system or with the overall financing system having influence beyond the Community budget therefore has a central importance for integration, and financing the Community has an objective related to regional policy[3] which will increase when we have a Europe of Twelve.

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1) W.v. Urff, "Zur Funktion des Grenzausgleichs bei Wechselkursänderungen im System der EWG-Agrarmarktordnungen" (The function of countervailing import duties in changes of exchange rates in the system of EEC agricultural market regulations), Agrarwirtschaft (Agricultural economy), Vol 23, No 5, 1974, p 169.

2) It is open to discussion whether redistribution in favour of poorer countries is sufficient for the policy of deflation and growth so often desired in these countries in the context of the basic integration theory to be made effective or supported in the long term.

3) In the graduated plan of the Werner Report financing the Communities is of practically no importance and even in Tindemans' concept of stage-by-stage integration no great importance attaches to finances for the purposes of integration. A different attitude is adopted in the Marjolin Report in which European regional policy has a special position; the "integration philosophy" stated there has already led to a demand for progressive revenue for the Communities and particularly to a proposal for the taxation of areas of industrial concentration. There has also been a demand for a Community fund for unemployment insurance which, if suitably planned, could also lead to redistribution by regions. For the MacDougall Group a European regional policy becomes the basis of the part to be played by public finance in European integration which they analyse and require. See Report to the Council and the Commission on the stage-by-stage introduction of Economic and Monetary Union in the Community (Werner Report), Brussels 1970, especially pp 8 et seqq and 13 et seqq; "European Union", Report by L. Tindemans to the European Council (the Tindemans Report), Bulletin of the European Communities, Supplement 1/76, especially pp 21 et seqq and 27; Marjolin Report, loc cit, pp 27 et seq and especially pp 32 et seqq; MacDougall Group, Vol I, especially pp 12 and 25 et seqq.

2.2 Redistribution between Member States by means of a Community revenue system

2.2.1 Distributing the financial burden; the demand for redistribution

2.2.1.1 Orientation by capacity to pay: concept and empirical picture

The demand for a progressive revenue system takes a central place in the discussion of the distribution of the financial burdens in the sphere of integration. In the context of its proposals for the future financing of the Community budget the Commission speaks of "avoiding a widening of economic differences", of "reducing economic differences" and demands that "in principle any regressive factor (should be avoided"[1].

In principle equivalence and capacity to pay should be invoked in the distribution of the financial burden, exactly as on the national plane. We must assume, however, that assessment of the financial burden by the equivalence principle is eliminated because a prescribed financial need has to be covered[2]. This raises the question of indicators of regional or national performance or ability to pay[3].

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1) Financing the Community Budget - Future method, Bulletin of the European Communities, Supplement 8/78, pp 20 and 8.

2) There are in any case limits to the use of the equivalence principle as regards the present tasks of the Community, as in the case of specifically public goods and transfer expenses, and in relation to the distribution of income between regions it has obvious shortcomings. See, however, Section 2.2.2 on net transfer accounts and the "juste retour". Considerations of equivalence are certainly important in assessing the "juste retour" or the compatibility of payments on the one hand and return flows of funds or benefits on the other from the point of view of the member countries.

3) The question of the effect of redistribution among States via Community financing on the distribution of national income is independent of the burden according to regional capacity. These effects arise from the incidence of payments made by the Member States to the Community budget. So long as a given tax yield is not divided and European taxes as such are not levied, financing is effected from the general revenues, regardless of what the tax is called, and the effects of the distribution in the individual member country are in line with those of its total funds. As regards personal distribution see also G. Denton, "Reflections on Fiscal Federalism in the EEC", Journal of Common Market Studies, Vol 16, No 4, 1978, pp 290 et seq.

In the concept of national taxation on the basis of capacity many indicators of capacity are discussed as possible bases of assessment and in the same way various standards can be used in the financing of the Community. These includes, for example, the gross or net national product at market prices, national income, disposable income or private consumption and other values such as national wealth, foreign currency reserves, government interests, the intensity of competition, individual or overall revenue-raising power or the production potential[1]. There might well also be a multi-dimensional indicator bringing in a number of social indicators.

The analogy with taxation according to capacity at national level breaks down because individual capacity is oriented to the possibilities of satisfying needs which are to be limited by taxation. This utility-oriented approach will not be pursued here; moreover, let us assume that the micro-indicators of individual capacity are reflected in the macro-values of regional capacity. It could also be argued against the analogy that if the Community is financed only in the context of a divided system there is a separate taxation system, whereas, for example, in the context of an allocation system only one assessment basis or apportionment formula is sought. While this distinction only becomes important when a fiscal adjustment system has to be established, we shall discuss in what follows the measurement of the capacity of the member countries or their power to contribute.

In the "quota concept" the quotas of the member countries in financing the Community budget can be calculated and compared with the relative shares of the member countries in the total product of the Community or other indicators of capacity.

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1) See also R. Peffekoven, "Internationale Finanzordnung" (International financial management), H. Gröner, A. Schüller (ed), "Internationale Wirtschaftsordnung" (International economic management), loc cit, pp 134 et seqq and R. Szawlowski, "Finanzen und Finanzrecht der internationalen zwischenstaatlichen Organisationen (IZC)" (Finances and financial law of the international inter-state organizations) (IZC), W. Gerloff and F. Neumark (ed), "Handbuch der Finanzwissenschaft" (Manual of the theory of public finance), Vol IV, 2nd edition, loc cit, pp 311 et seqq.

In the case of a tax on added value, energy consumption, tobacco, alcohol, etc, the bases of assessment can be examined as to whether they can be correlated on the same lines as the selected indicator of capacity. If that is not so and taxation based on capacity is required, corrective mechanisms will be needed to ensure proportional taxation so as to prevent over or under-payments. In making these comparisons attention must be paid to the timing of the bases of assessment and the capacity indicators. For example, if all countries are required to pay 1% of a harmonized assessment which is not identical with the gross national product as a capacity indicator and if its value fluctuates differently between one country and another, there will be regional effects of distribution which may inhibit further integration. In the case of the value-added tax scheme, if the assessment based on the national product declines in one country while by comparison it increases in another, tax would not be proportional. This development is possible in the case of all taxes and contributions where the basis of assessment is not the same as the capacity indicator. From this point of view it would therefore seem appropriate to orient financing to the gross national product (see C).

If the gross national product is recognized as an indicator of capacity the financing quotas of the countries in the total budget of the Community[1] and/or in certain types of revenue can be compared with their shares in the

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1) See Federal Ministry of Finance documentation 6/77, 6/78 and 4/79, also Financial Report 1978, Bonn 1977, p 53, Financial Report 1979, Bonn 1978, p 49 and Deutsche Bundesbank, "Die wachsende Bedeutung der Europäischen Gemeinschaften für die öffentlichen Haushalte der Bundesrepublik" (The growing importance of the European Communities for the public authorities of the Federal Republic), Monthly Reports of the Deutsche Bundesbank, January 1977, pp 15 et seqq. The composition of the German financing quota can be seen from the table taken from the Financial Report 1978, p 54

German quotas of the Community budget
in million ua

	1973	1974	1975	1976	1977[1]	Increase 1977:[illegible]
I. Community budget						86.73%
II. German quota[2] as percentage:						
absolute:						
Customs duties			[Voir original]			
Price adjustment levy						
Sugar duty						
Financial contributions						
Total in DM[3]						73.[illegible]

1) incl overlap-period item 1/77.
2) Finance volume after ruling of 21 April 1970 (excl other revenues).
3) 1 ua = DM 3.66

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"gross national product" of the Community to find out whether the member countries are contributing to the finances in proportion to their economic performance or production capacity. Table 1 shows these quotas for 1978 and the hypothetical contributions in the context of the value-added tax scheme. It is evident that in 1978, in the case of the overall financing quotas, "rich" countries like France and the Federal Republic of Germany, paid less than would have corresponded to a tax proportional to GNP. "Poor" countries, like Italy, Ireland and the United Kingdom, on the other hand, paid more than was proportional to the national product.

This approach can be applied to the various types of revenue (customs duties, price-adjustment levy and sugar duty, financial contributions) and in future to value-added tax and, as will be seen, leads to different verdicts on the implementation of financing on the principle of capacity. If a policy of redistribution was to be adopted on the basis of these results, more finance would, other things being equal, have to be provided from the rich countries, and Community customs revenue and the price-adjustment levy would be virtually useless for the purpose of redistribution among States. Efficacy for redistribution policy could only be examined in the case of financial contributions and value-added taxes and, above all, in relation to new Community revenues.

The results of quota calculations are open to argument. In these analyses of the flow of payments, customs duties and agricultural price-adjustment levies due to the Community budget are charged to the Member State which receives them and has to pass them on. The yield from customs duties in the Community countries therefore fluctuates because of geographical conditions and for that reason alone cannot be usefully included in the calculations[1)]. Then there is the further-reaching objection that with the development of the "own-resources" system revenues accruing to the Community should be omitted from the calculation of financing quotas.

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1) For example, a dockers' strike in the United Kingdom leads to more duty being paid in Germany and the Netherlands. The two last-named countries therefore increase their contribution to Community financing, whereas the United Kingdom contribution drops.

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Table 1: The financing quotas of the countries, in total and by types of revenue in 1978[a)]

	GDP[1)]	Population[2)] (1977)	Financing quotas Total[3)]	Customs duties[4)]	Agricultural price-adjustment levies and sugar duties[4)]	Own resources	Financial contributions[5)]	(7) : (1)	Financing quotas VAT[6)]
	% (1)	% (2)	% (3)	% (4)	% (5)	% (6)	% (7)	(8)	% (9)
Belgium									
Germany									
France									
Italy									
Luxembourg					/V o i r o r i g i n a l/				
Netherlands									
Denmark									
Ireland									
United Kingdom									
Community									

a) VAT scheme not yet in force in 1978.

1) Commission of the European Communities, Directorate-General for Economic and Financial Affairs, European Economy, Annual Economic Report 1978-1979, November 1978, No 1, p 87 (GDP at current prices and exchange rates).
2) Eurostatistics, data on cyclical economic analysis, SOEC, January 1979, p 13.
3) Official Journal of the European Communities, L36, Vol 21, 6 February 1978, p 40.
4) Ibid.
5) Official Journal of the European Communities, L121, Vol 21, 8 May 1978, p 8.
6) Official Journal of the European Communities, L36, Vol 21, 6 February 1978, p 40.

Customs duties, price-adjustment levies and sugar duties would then be European revenues and although they would be paid in the member countries, they would not, for that reason, enter into the calculation of the national financing quotas. If this view is adopted, the question arises as to which revenues can reasonably be considered for this purpose. If quotas are calculated without the Community's own resources, only the financial contributions can be considered. The result for 1978 can be seen from Table 1. With the exception of Italy and the UK, all the countries paid less than was proportional to their quotas as calculated on the basis of national product[1]. If we consider the corresponding quotas for 1978 under the contribution and the value-added tax systems, Italy comes off better and France worse under the value-added tax system than under the financial contribution system generally applicable up to and including 1978. Italy will be encouraged to adapt national legislation as quickly as possible to the harmonized basis of assessment so as to hasten the change to the value-added tax system. As against this, however, the figures relating to value-added tax are very rough estimates.

Such quota calculations lose importance when the change to the own-resources system is complete and value-added tax replaces the financial contributions[2]. After all, the revenue-raising jurisdiction in the matter of own resources lies wholly or partially with the Community; for the Member States they are only "self-balancing items" and in the case of price-adjustment levies and the sugar duty they are recompensed for collection and administration.

These objections certainly do not imply that it is useless from the economic point of view to ask which country transfers the funds. If determination of the regional incidence of Community revenue is of interest in connection with redistribution, the incidence of the obligation to pay, ie the

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1) A different picture presents itself if the relevant shares of Community GDP are expressed not only in EUA but in terms of purchasing power. Calculations have shown that the shares calculated in purchasing power parities are lower for France and the Federal Republic and higher for the United Kingdom and Italy. See Eurostat, National Accounts ESA, 1960-1977, SOEC, loc cit 1978, pp VIII et seqq and pp 38 et seq of this paper, also Table 2 and Table 4 of the Annex.

2) Also G. Isaac, "La rénovation des institutions financières des communautés européennes depuis 1970" (The renewal of the financial institutions of the European Communities since 1970), Revue trimestrielle du droit européen (Quarterly review of European Law), 1973, p 695.

distribution of the payments made, can be regarded as the first stage of a deeper analysis of incidence. The question who is responsible for payments of duty and transfers of price-adjustment levies and shares of value-added tax to the Community budget brings us to the problems, already referred to, of the passing on of charges by one region to another. On the basis of assumptions regarding such passing-on of charges, which take into account regional patterns of consumption of dutiable goods and goods subject to market regulation, other results are reached (eg compare column 6 and Column 2 in Table 1).

We can only refer briefly to the effect of the European unit of account (EUA) on financing quotas; until 1978 it had fixed parities and differed from the market exchange rate of the currencies of the member countries (see footnote to Table 1 of the documentation). When exchange rates had been allowed to float the market rate dropped below the domestic rate (budget unit of account) for the hard-currency countries while the opposite was true for the soft-currency countries. From this situation it is concluded that the hard-currency countries were paying relatively too much to the Community budget and the soft-currency countries too little (see Table in Annex 2).

With the change to the new EUA the discrepancies between the market and conversion rates become less important. Exchange at market rates in 1978 meant a saving of national currency for the revaluing countries and a greater expenditure of national currency for the devaluing countries. Whether this also applies to own resources is in doubt, as these are only transferred via member countries for technical reasons. The revenue-raising jurisdiction for own resources rests with the Community and discrepancies between the market rate and the domestic rate cannot therefore affect the level of the relevant financing quotas. If we follow this argument the differences in rates up to 1977 would only have been important as regards the level of the financial contributions. If the market rates are accepted as a system of valuation the hard-currency countries were then paying more and the soft-currency countries less to the Community budget. The excess payment made per unit of account by the Federal Republid of Germany, as a hard-currency country, would then have amounted to the difference between DM 3.66 and the current market rate, which was lower. This excess payment by the hard-currency countries was counteracted in that the GNP shares of the member countries in the Community product, which have formed the basis for calculating the financial contributions since 1975, were also, until 1977, calculated on the basis of the budget units of account (official parities) and with this valuation the Federal Republic had a smaller share in the European product than would have been the case if the contribution had been calculated from market prices. In other words, the national product converted at DM 3.66 per ua is lower than the national product expressed in ua at the market rate of DM 2.69 (value at 1 February 1977). In this connection the Bundesbank maintains that the effect of the exchange rate already described would be greater than the effect of this valuation basis, but disregards the fact that the effect of the exchange rate decreases if we accept the above argument on the disregard of own resources. In this case the effect of the exchange rate would apply only to the financial contributions and the relative financing quotas based on market rates would be raised much less than the Bundesbank assumes[1].

2.2.1.2 The demand for redistribution and its feasibility

In view of the importance that has emerged of regional redistribution for further integration and having regard to the fact that expenditure from the Community budget is being used to a greater extent in the interests of redistribution, the part played by revenue as an instrument of regional redistribution comes into the picture[2]. How small its influence has so far been compared with expenditure in existing federal and unitary states can be seen in Table 3 of the Annex, where the MacDougall Group has tried to show the domestic power for regional redistribution of the central or federal finances (with government shares between 20 and 25%). If the Community finances were really to achieve the same importance in the future (after a suitable increase)[3], with a higher progression on the revenue side, it would be possible to reach a desired measure of redistribution with a slower-growing budget

1) In this connection see W. Heck, "Die neue Europäische Rechnungseinheit" (The new European unit of account), Wirtschaftsdienst, (Economic Service) No 2, 1978, pp 87 et seqq.

2) But see also the view expressed by Vollerthun at an earlier stage of integration that there is a contradiction between the impersonal character of governments and the progression oriented on individual peculiarities. H. Vollerthun, "Finanzwirtschaftliche Probleme internationaler Organisationen. Unter besonderer Berücksichtigung der Europäischen Gemeinschaften" (Problems of financial management in international organizations. With special reference to the European Communities), Dissertation, Heidelberg 1968, p 21 et seq.

3) If the finances were shifted "upwards" this situation would necessarily affect the national power of redistribution.

than if redistribution were achieved solely via expenditure[1].

If, in spite of possible objections based on growth, inter-State redistribution is in the forefront and if Community expenditure and a horizontal fiscal adjustment are disregarded, Community financing could contribute towards redistribution in that it would make rich countries bear a bigger burden and poor countries a smaller burden in comparison with a capacity indicator. This levelling effect could also be described as a "vertical distribution of revenue with a horizontal effect". It seems, however, that the use of regional policy to affect attitudes by means of the revenue side - by disproportionate over or under-taxation - is more difficult than on the expenditure side. Financing could be used to influence the attitudes of countries contributing a relatively small amount if "regional tax concessions" were granted only where evidence was brought of the regional assistance required. In principle, such reliefs are similar to the adjustment mechanism worked out in 1975, which provides for "re-transfers" in certain cases but had not been applied up to 1979[2].

To reduce economic differences the Commission proposes a corrective factor which would establish politically an apportionment formula for the revenue-raising power or ability to contribute of the member countries. A given difference of income between two countries would then mean that

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1) If there were a Community effort which raised the European share from 0.8 to 2-2.5%, the MacDougall Group expects that differences in income in a Community of Nine would drop by 10%, at least if this European activity covered regional, labour, market and economic action so that maximum power of redistribution with a given burden on the budget was the objective. Beside this optimistic expectation there are some very sober estimates. If fiscal adjustment is regarded as a political problem which is even less amenable to rational solution internationally than on a national plane, "we would probably be well advised not to expect too much from an international or supranational fiscal adjustment of this kind". See K. Schmidt, "Zur Koordination von Steuern bei wirtschaftlicher Integration" (The Coordination of taxes in economic integration), E. Schneider (ed), "Weltwirtschaftliche Probleme der Gegenwart, Schriften des Vereins für Socialpolitik" (World economic problems of the present, Papers of the Association for Social Policy), new series, Vol 35, Berlin 1965, p 466.

2) See Documentation, p 7, and for more details, J.R. Dodsworth, "European Community Financing: An Analysis of the Dublin Amendment", Journal of Common Market Studies, Vol XIV, 1976, pp 129 et seqq.

the richer country would not only pay the proportionate rate but would also have to transfer additional funds[1]. This supplement could be calculated by applying the corrective factor to the underlying per caput capacity to pay (eg GDP, consumption, personal income) and multiplying this index by the average per caput income of the Community and the population figure at the time. The resultant relative shares could then be applied to any basis of assessment (see Table 4 in the Annex).

An alternative to alignment with the gross national product would be an approach from the angle of revenue-raising power[2]. If it is to be calculated on the basis of personal income (personal income tax capacity key), it would be necessary to pick out from the national product calculation the value corresponding to the basis of assessment for income tax. In Table 2 this basis of assessment y_n is entered in Column 1. A new basis of assessment with a higher variance, ie bigger differences of financial strength between "poor" and "rich" countries, is calculated as follows: Multiply the difference Δx_n by a factor F, add 100, divide this sum by 100 and multiply the whole expression by the average Community income $\bar{y}$. These values are described as the corrected personal income base (Index II). The sum of the incomes obtained in the Community and the income tax paid on them gives the average rate of tax in the Community ($\bar{t}$). If the new assessment basis (Index II) is multiplied - for each country - by the number of persons gainfully employed (E_n) and the average rate of tax ($\bar{t}$) a new basis is obtained (personal income tax capacity) for the calculation of new financing quotas (personal income tax capacity key). The values calculated in the context of the approach from the angle of revenue-raising power can be juxtaposed with the countries' shares of GDP - according to purchasing power and exchange rates.

This calculation procedure involves a number of technical and statistical decisions which affect the economic force of the revenue-raising power

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1) See "Finanzierung des Gemeinschaftshaushalts - Künftige Methode" (Financing the Community Budget - Future method), Bulletin of the European Community, Supplement 8/78, p 21.

2) The MacDougall Group prefers an indicator of revenue-raising power to indicators of national capacity available direct from the calculation of the national product. See Vol II, pp 457 et seq. See also G. Hedtkamp, "Lehrbuch der Finanzwissenschaft" (Manual of the theory of public finance), 2nd edition, Neuwied 1977, p 69, and W. Wittmann, "Einführung in die Finanzwissenschaft" (Introduction to the theory of public finance), Part III, 2nd edition, Stuttgart, New York 1976, p 115.

Table 2: Calculation of a personal income tax capacity key

	Proxy personal income base	Index I $\vec{y}$ = 100	Differences from 100	Index II (corrected personal income base)	Personal income tax capacity	Financing quotas
	(1)	(2)	(3)	(4)	(5)	(6)
Belgium						
Germany						
France						
Italy						
Luxembourg						
Netherlands						
Denmark						
Ireland						
UK						
Community of 9						

[Voir original]

approach. In particular the choice of the proxy assessment base and the type of tax has effects which are specific to a given country; these have an appreciable influence on the revenue-raising power key and in theory can also produce an adjustment attitude in the countries. Behind all these different problems, however, there is the basic question as to indicators of national capacity and it is difficult to justify the use of revenue-raising indicators for the purposes of international comparison instead of existing and harmonized national product values.

The proposed limitation of consideration to the effects of regional distribution on the revenue side must not blind us to the fact that in the political conflict as to the proper burden of contributions, the problem of the "juste retour", ie the balance between payments to the Community budget and benefits received by the member countries, is in the forefront. This disputed comparison of payments and benefits produces the level of net receipts or net payments, which may be regarded as the volume of redistribution. It shows how much inter-State redistribution has taken place in consequence of Community financing.

2.2.2 Net transfer accounts and inter-State redistribution

The arguments relating to countries are widened if reverse flows of expenditure[1] from the Community budget to the member countries are

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1) The expenditure side is also affected by the valuation of the unit of account. Until 1977 payments outside agriculture were subject to the official conversion rate; since 1978 they have followed the market movements of the EUA and have therefore been lower for the Federal Republic of Germany. Whereas expenditure on agriculture and social security accrues and is repaid in national currency, there are variants in the case of the Regional Fund from which quotas in ua are determined for Member States over the long term; in the case of the DM the equivalent of these dropped on the introduction of the EUA. There would be further repercussions if the EUA ceased to be a clearing unit and became a payment medium so that the member countries would have to bear the exchange rate risk. See W. Heck, "Die neue Europäische Rechnungseinheit" (The new European unit of account), Wirtschaftsdienst (Economic Service), No 2, 1978, p 91.

calculated accordingly and compared in turn with capacity indicators. Table 3 shows flows of funds back to Member States in 1977, in total and by types of expenditure. In the last column total "repayments" and shares of GDP are compared. The comparison shows that all countries except France, Germany and Luxembourg receive more than is proportionate to their share of GDP.

A distribution of funds among Member States classified by type of expenditure and by country gives a first basis for analyses of regional incidence or the extent to which the regions are affected by expenditure; the methodical problems of this do not differ in principle from those of regional analysis on the national plane and may be specified separately for agricultural, regional or social expenditure. The question arises whether the analysis should be confined wholly to an examination of the flow of funds to the regions and exclude processes of the appropriation of benefits to the regions in order to go beyond the determination of formal incidence. As regards the attribution of expenditure or services to regions, procedure could then be similar to that for the distribution of public services among different strata of the population[1]. In all cases the objective of regional attribution will be to show the influence specific to the Community. In the present context the importance of the return-flow calculations appears in the balancing of outward flows and return flows[2].

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1) See K.-D. Henke, "Die Verteilung von Gütern und Diensten auf verschiedene Bevölkerungsschichten" (The Distribution of goods and services among various strata of the population), Göttingen 1975, p 103 et seqq, and in the regional context, R. Timmer, K. Töpfer, "Zur Regionalisierung des Bundeshaushalts: Raumordnungspolitische Bedeutung und empirische Ergebnisse" (Regionalization of the Federal budget: Its importance to regional policy and empirical results), Räumliche Wirkungen öffentlicher Ausgaben, Veröffentlichungen der Akademie für Raumforschung und Landesplanung, Forschungs- und Sitzungsberichte (Regional effects of public expenditure, Publications of the Academy for regional research and land planning, research and conference reports), Vol 98, Hanover 1975, p 213 et seqq, and H. Zimmermann, "Regionale Inzidenz der öffentlichen Realtransfers - Probleme ihrer empirischen Ermittlung" (Regional incidence of public material transfers - Problems of empirical determination), M. Pfaff (ed), "Problembereiche der Verteilungs- und Sozialpolitik, Schriften des Internationalen Instituts für Empirische Sozialökonomie (INIFES)" (Problems of distribution and social policy, Papers of the International Institute for Empirical Social Economy), Vol 2, Berlin 1978, p 345 et seqq

2) After much hesitation and many reservations the Commission decided to produce net accounts for 1976/77, as figures which were often misleading were brought up at the discussion on integration policy. See Table 5 of the Annex. See also Statistische Beihefte zu den Monatsberichten der Deutschen Bundesbank (Statistical supplements to the monthly reports of th Deutsche Bundesbank), Series 3, Zahlungsbilanzstatistik, (Balance of [illegible] and Federal Ministry of

Table 3: Shares in return flows of funds by Member States in 1977 (million EUA) 1) 2) 3)

	GDP	Population	European Agricultural Guidance and Guarantee Fund: Guarantees 4)	European Agricultural Guidance and Guarantee Fund: Guidance measures	Social Fund	Regional Fund	Total	(7) : (1)
	%	%	% abs	% abs	% abs	% abs	% abs	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Belgium								
Germany								
France								
Italy				/Voir original/				
Luxembourg								
Netherlands								
Denmark								
Ireland								
United Kingdom								
Community								

1) The Table covers only the 4 Funds (EAGGF (2), Social Fund, Regional Fund). Other categories of expenditure, such as administration, research and development, and development aid, which account for, say, 10% of total expenditure, are disregarded in the allocation.
2) The various units of account used in the annual reports are all converted into EUA.
3) In the case of the structural funds (Regional Fund, Social Fund and EAGGF, Guidance Section), the flows of payment relate to commitment authorizations; in the case of the EAGGF, Guarantee Section, they relate to payment authorizations.
4) Corresponds to the MCA accounting system before May 1976. For an explanation of the two accounting methods see Written Question No 604/78, 1020/77, 607/78 from Mr Cointat and Lord Bessborough to the Commission of the European Communities, Official Journal of the European Communities No C 28/1, 31 January 1979; the amounts shown in the table in the written question for the net transfers (difference between the return flows via the appropriate expenditure funds and inflows of financial resources) are based not on commitment authorizations but on payments actually made; this table, which is reproduced in the Official Journal, shows the net transfers for 1976 and 1977 for both MCA accounting methods. There the expenditure is assigned to the Member States and the administrative expenses are attributed to the Benelux countries.

Drawn up and calculated from the Annual Reports of the different Funds.

Without disputing the political importance of "net accounts"[1), "equivalence financing" of the Community is not in the spirit of the Community nor does it comply with the letter of the EEC Treaty and the Merger Treaties. If a "juste retour" in the sense of a balance between payments made and repayments or benefits received nevertheless frequently appears to be a guiding principle of financing in day-to-day politics, the distributive function of the Community budget is greatly restricted. If the actual expenditure was charged to those benefiting from it in the form of a costs levy, the Community would be unable to perform its task of regional redistribution or could only do so at the cost of concessions in other fields[2)]; to this extent "equivalence thinking" is one of the causes of the growth of the Community budget. At the same time the use of net accounts is evidence of a certain hostility to integration or suggests a lack of solidarity. It recalls the attempt of members of an insurance society to "get back" as much as they can in payments and benefits over and above the contributions they have paid.

If the "juste retour" is really to be regarded as a financing maxim, at least all the other advantages of integration, such as the elimination of customs duties, the diversion and creation of trade flows with their associated effects on prosperity, and all the disadvantages of integration would have to be quantified in money terms and compared in a cost-benefit analysis[3)]. To this end it would be necessary to consider the total regulatory activity of the Community together with its budgetary activity. The intermittent advantages and disadvantages of integration would have to be considered in just the same way as the activities of the European Investment Bank, the European Coal and Steel Community and the European Development Fund[4)]. For all these reasons we must largely agree with

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1) Even in the context of fiscal adjustment within the Federal Republic the net position is important to the views of the Länder on the reform of §§ 91a and 104a of the Basic Law. It would be logical for the recipient Länder to be in favour of continuance of Community expenditure and for the donor Länder to oppose it.

2) See K. Reding, "Zur Problematik eines Finanzausgleichs in der Europäischen Gemeinschaft" (The problems of fiscal adjustment in the European Community), H.v.d. Groeben, H. Möller (ed), Möglichkeiten und Grenzen einer Europäische Union (Opportunities and limits of European union), Vol 2, loc cit, p 206 et seqq.

3) B. Ballassa, "Trade Creation and Diversion in the European Common Market: An Appraisal of the Evidence", B. Ballassa (ed), European Economic Integration, Amsterdam 1975.

4) For example, as a "quid pro quo" for the desired membership of the EMS, the United Kingdom demanded an improvement of its net transfer position and Ireland an increase in direct grants from the Regional Fund. Finally, in the case of Ireland, the grant was made via the European Investment Bank so as not to involve the European Parliament - at the wish of the French.

Reister in regard to the incidence level of incoming funds and payments of contributions if analysis of the flow of payments "solely from the point of view of setting the financial contributions paid by a Member State against the benefits received" is regarded as an "inefficient and limited attempt to measure the worth a country derives from membership"[1]. Ultimately it will depend on the awareness of integration and solidarity how long considerations of this kind continue to be important. It certainly should not be forgotten that even at national level such matters are carefully weighed up when marginal changes in revenue-raising regulations are contemplated[2].

2.2.3 Further-reaching analyses to determine the regional incidence of Community financing

Apart from overall net transfer accounts, partial net accounts can be produced and other Community institutions can also be taken into consideration. Overall offsetting conceals the possibility that in the case of partial offsetting a country will be in a position different from that in the case of overall accounting. Still more importance attaches to analyses which depart from the status quo and either simulate alternative Community policies or examine hypothetical situations in the absence of the Community. The suggestion often made that accounts with and without the existence of the Community or with and without its budget are irrelevant can be countered by the argument that in this way comparative standards are found which help in assessing the further development of integration. Disaggregation of the net transfer account will occur if various expenditure programmes are analysed in respect of their incidence, including their financing.

In calculating partial budget incidence the question arises as to what

1) E. Reister, "Haushalt und Finanzen der Europäischen Gemeinschaften" (Budget and finances of the European Communities), Baden-Baden 1975, p 97.

2) See also the Study of the European Parliament, The effects of (sic) the United Kingdom of membership of the European Communities, February 1975.

3) On the results of such accounts see E. Reister, "Haushalt und Finanzen der Europäischen Gemeinschaften", loc cit, p 100 et seqq.

receipts and expenses can be usefully compared if the basis is the non-allocation principle. Should a category of expenditure be "accounted for" (a) in proportion to the distribution of total income according to member countries, (b) in proportion to the part of the Community budget financed by individual income items or (c) in proportion to the financing structure of the growth rate of the Community budget?

For an analysis of his sector the Federal Minister of Food, Agriculture and Forests selected the proportional approach. According to this the Federal Republic paid a net 687 million ua in the agriculture sector in 1976[1]. On the basis of a comparable approach Scheper arrives at the figure of DM 1496 million as the actual burden for 1976. In his case the "financial transfer from the Federal Republic to the Community budget for farming purposes" includes "the financial contribution of the budgets of the Federal Republic for farming purposes ..."
"the part of the Community's own resources for farming purposes ...", ie price-adjustment levies, countervailing import levies and sugar duty[2]. Instead of the proportional approach, therefore, Scheper chooses assumptions based on a factual connection between "agricultural revenue" and "agricultural expenditure".

The results of other Community policies could also be simulated, for example an agricultural policy hypothetically converted to direct income aids[3]. Finally, questions could be asked about a situation without a Community, or without a Community budget, and by means of assumptions a standard situation for assessment could be created, for example the bilateral coordination of international tasks or the performance of

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1) Agrarbericht (Agricultural Report) 1978, Bundesrat document 50/78 of 3 February 1978, p 65.

2) See W. Scheper, "Gesamtwirtschaftliche Umverteilungseffekte der Agrarpolitik, Referat für die Jahrestagung des Vereins für Socialpolitik" (Economic redistribution effects of the agricultural policy, Paper for the annual conference of the Association for Social Policy), 1978, duplicated in manuscript form, p 11.

3) See W. Albers, "Die Wirkung von Agrarsubventionen auf Allokation und Verteilung" (The effect of agricultural subsidies on allocation and distribution), G. Schmidt, H. Steinhauser (ed), Planung, Durchführung und Kontrolle der Finanzierung von Landwirtschaft und Agrarpolitik, Schriften der Gesellschaft für Wirtschafts- und Sozialwissenschaften des Landbaues e.V. (Planning, implementation and control of the financing of farming and agricultural policy, Papers of the Society for Economic and Social Sciences in Farming), Vol 15, Munich, Basle, Vienna 1978, p 33 et seqq, and U. Koester, "EG-Agrarpolitik in der Sackgasse" (Community agricultural policy at a dead end), Baden-Baden 1977, p 159 et seqq.

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national tasks. As regards the objective of redistribution between States assumptions would have to be made as to alternative attitudes in the absence of the Community; as regards financing it would be necessary to consider what the national burden would be if national and bilateral agreements took the place of Community regulations. With regard to customs receipts reference situations in the absence of a customs union could be thought out and on the basis of these calculations could be made as to the level which would have been reached by national customs receipts[1) 2)]. Whichever type of incidence analysis is preferred, it is unlikely that its results will coincide with those of a method based solely on flows of payments, and political decisions will have to be reached on an insufficient basis.

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1) See H. Vollerthun, "Finanzwirtschaftliche Probleme internationaler Organisation. Unter besonderer Berücksichtigung der Europäischen Gemeinschaften" (Problems of financial management in international organizations. With special reference to the European Communities), loc cit, p 89 et seqq.

2) In the sphere of Community agricultural policy Scheper has, on the basis of certain assumptions, calculated the fiscal effects if "the Community of Nine" was changed into "nine mini-Communities" and the nine mini-Communities adopted the same agricultural policy as regards the part of it which is now determined by the Council of Ministers or the Commission. The table shows the results of this comparison. As it is assumed that no changes occur for the producers and consumers of agricultural produce, the difference shows the extent of the indirect horizontal fiscal adjustment in favour of other Community countries. This difference can also be regarded as the price of the common agricultural policy or as a contribution towards realization of economic integration.

Table: The fiscal burden on the Federal Republic of Germany in DM million under national and European agricultural policies

	Net transfer from Germany to the Community budget for farming purposes	Relief for the German budgets	"Indirect horizontal fiscal adjustment" in favour of the agriculture sector of other Community countries
1971			
1972			
1973		/Voir original/	
1974			
1975			
1976			

See W. Scheper, "Gesamtwirtschaftliche Umverteilungseffekte der Agrarpolitik" (Economic redistribution effects of the agricultural policy), loc cit, quotation p 12.

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V. The standards required of a rational Community revenue system

A revenue system, which at least does not hold back the future integration process, can be developed from the following criteria which also assist in the assessment of the financing proposals; they have been derived from the preceding comments.

A. Economic criteria:
- National capacity taken into account
- Usefulness for redistribution between regions
- Usefulness for purposes of stability
- Avoidance of distortion of competition

B. Legal criteria:
- Own resources system in accordance with Article 201, Treaty of Rome

C. Integration criteria:
- To strengthen the revenue autonomy of the Community

D. Technical criteria:
- Adequate and lasting yield
- Cheapness of collection
- Little need for harmonization
- Little adverse effect from differing national standards of honesty in tax matters
- Little adverse effect on national tax flexibility
- Little effect on fiscal adjustment within the country
- Perceptibility
- Cheapness of payment

It is clear that some of the criteria may be regarded as specific to the Community revenue system so that, exactly as in the case of rational systems of local authority revenue, criteria of rationality may be found for the Community budget; as standards they are associated with the general principles of taxation. In the event of objectives conflicting with the general principles of taxation priority could be given to the standards for Community revenue in the interests of progressive integration[1].

The application of these criteria and their weighting[2] depends in the first instance on the stage of integration reached. The small fiscal needs of a customs union can be covered by a system of contributions to costs. Discussion of fiscal adjustment systems will gain importance only to the extent that supranational tasks have to be performed at successive stages of integration. The importance of the criteria therefore depends first on the degree of revenue autonomy achieved and secondly on the functions allotted to the revenue of a newly created level[3].

Apart from this approach, in which revenue and the system of the vertical distribution of funds are regarded as dependent variables, we have the

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1) By analogy with the views of the Economic Advisory Council on the relationship of general tax principles to the standards required of an appropriate system of local authority taxation, the settlement of a conflict of objectives in favour of a European revenue system could be accepted more readily the greater the share of the tax receipts determined by the central authority of the member countries on the basis of general tax principles. See Opinion on the local authority tax system and local authority reform in the Federal Republic of Germany, 16 March 1968, Der Wissenschaftliche Beirat beim Bundesministerium der Finanzen, Entschliessungen, Stellungnahmen und Gutachten 1949-1973 (The Economic Advisory Council at the Federal Ministry of Finance, decisions, comments and opinions) 1949-1973, loc cit, p 409.

2) In the past Dosser has pleaded for financing through corporation tax and derived this view from the theory of equivalence. If this view, which Dosser related only to the business sector, is shared, the idea of equivalence could also be adopted as a subsidiary condition for a rational revenue system. See D.G.M. Dosser, "Der Gemeinschaftshaushalt und die Haushalte der Mitgliedstaaten" (The Community budget and the budgets of the Member States), (Commission of the European Communities, Group of Experts on Economic and Monetary Union, European economic integration and currency union), loc cit C II, p 60 et seq; see also K. Schmidt, "Zur Reform der Unternehmungsbesteuerung" (The reform of business taxation), Finanzarchiv (Financial Records), new series, Vo. 22, 1962/63, pp 35 et seqq, particularly pp 50 et seqq and pp 60 et seqq.

3) It is not out of the question that if the Community is enlarged a different vertical means of adjusting revenue will be created in the first place for countries joining because the value-added tax arrangement presupposes adjustment to the harmonized basis of assessment. At the same time this means that the assessment criteria cannot be applied to all vertical relationships and that their weighting will differ from one country to another.

approach in which revenue is designed to relate to integration. Thus the Community hoped for an impetus towards integration from the own resources decision of 1970 and efforts for redistribution between regions with the aid of revenue point in the same direction.

In view of the many rational revenue systems and the circumstance that those in favour of integration of the Community countries will not bind themselves in advance to any given type or method of integration, we shall not go into the concept of an optimum financing system but in what follows will discuss some financing proposals going beyond the status quo, which might be applied in the case of an economic and monetary union and would not endanger still further-reaching efforts for integration for reasons to do with finance.

C. Further development of Community financing with a view to integration

I. Financing proposals in the context of fiscal adjustment

1. Financial needs and financing proposals

In all probability the Community will require new sources of revenue in 1981/82; by that time revenue from the value-added tax part will be fully utilized[1]. Discussions on financing will become still more important if the additional financial needs when the Community is enlarged are considered and long-term developments are taken into account[2]. If the integration

1) See "Erweiterung der Gemeinschaft, Beilagen zum Bulletin der EG" (Enlargement of the Community, Supplements to the Community Bulletin), Nos 1-3, 1978. The calculations presented there indicate a financing requirement of a thousand million units of account, which would be payable as the price for the Community of Nine if applicant countries were fully integrated.

2) The MacDougall Group sees the relationship between the state of integration and the share of the Community GNP as it appears in the following table.

Table: State of integration and Community government share

State of integration	Share of GNP_G
present position (1977)	0.7%
pre-federalistic integration	2.0-2.5%
federation with small public sector	5.0-7.0% 7.5-10.0% (including defence)
federation with large public sector	20.0-25.0%

Compiled according to MacDougall Group, Vol I, p 14; see also Notice of the Commission to the Common Council of Foreign and Finance Ministers and to the European Parliament (1978), p 5.

process is not to be endangered from the revenue angle, the basic financing possibilities and concrete revenue alternatives must be analysed in good time. So far this examination has been sporadic and it was first undertaken systematically by the MacDougall Group[1)] and particularly by the European Commission[2)].

Survey 1 is intended to show what criteria and financing proposals have been considered in the past. The concrete financing proposals include not only an expansion of Community borrowing but more especially an increase in the share of value-added tax to 1.5% or 2% of the common assessment basis. Proposals have also been put forward for financing on the basis of assessments other than value added. Excise duties (on mineral oil, tobacco, alcohol, motor vehicles and luxuries), income and corporation tax and a number of other levies (levies on energy in the form of an import duty on OPEC oil, on Community farm produce, congested areas, etc) are also among the financing proposals. In line with the limits imposed at the beginning of this paper, we shall not go into the obvious suggestion that economies should be effected in expenditure or that expenditure should be switched in favour of other tasks[3)].

2. The relationship to fiscal adjustment

It would be impossible to discuss the concrete proposals for financing without reference to fiscal adjustment and its systems. In principle revenue can be distributed vertically and horizontally.

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1) See MacDougall Group, Vol II, Chapter 16.

2) Financing the Community Budget - Future Methods, Community Bulletin, Supplement 8/78; this publication invites the European Parliament, the Council of Ministers and the Member countries to come to terms with the problem of financing.

3) A further analysis of Community borrowing is also omitted because it would be impossible without a detailed survey of current borrowings and would also have to be considered in conjunction with the European currency system.

Survey 1: **Assessment criteria and proposals for financing the Community budget**

	European Parliament	MacDougall Group	EEC Commission	Others
Criteria		- Yield - Distributive effect - Problems of administration - Political considerations - Economic considerations	1. Technical considerations - uniform basis of assessment - broad application - abundant and inexhaustible sources of revenue - little opportunity for tax fraud - simple administration 2. Institutional/legal considerations - Funds must not be subject to decisions by Member States (genuine own resources) 3. Economic considerations - Yield/capacity to pay - Redistribution	
Proposals	- 2% VAT - Special levies - Percentage of other existing taxes - Specific new Community tax	- VAT above 1% - Contribution key based on financial capacity or overall national values - Corporation tax - Tax-expenditure programmes - Levies from minimum oil price system - Levies for an unemployment fund - Borrowing	- VAT - Cigarette tax - Alcohol tax - Corporation tax - Income tax - Energy tax - Petrol tax	- Levy on settlements in congested areas - Land value growth tax - Production levies on farm produce

Sources:
- Report on behalf of the Budget Committee on the guidelines of the European Parliament on Community Budgetary and Financial Policy for 1979, Conference Documents 1978-79, 3-78, p 22.
- MacDougall Group, Vol II, Chapter 16.
- Financing the Community Budget - Future Method, EEC Bulletin, Supplement 8/78, p 17 et seqq.
- H. Giersch: "Plädoyer für eine europäische Regionalpolitik" (Plea for a European regional policy), European Commission, Group of Experts on "Economic and Monetary Union", loc cit, D-I, p 86 et seqq.
- D. Biehl: "Zur Rolle der öffentlichen Finanzen in der Europäischen Integration" (The role of public finance in European integration), Integration, No 2, 1978, p 35 et seqq.

A horizontal fiscal adjustment between individual Member States tends to be a marginal note to the comments, as the main concern is to finance the Community budget and in the event of a horizontal distribution of revenue there would be direct equalization between financially strong and financially weak member countries. To this extent horizontal fiscal adjustment is a method of financing which may be chosen instead of or in addition to financing via the Community budget[1]. Financing via horizontal fiscal adjustment in the wider sense can also cover proposals to communalize parts of the social insurance system and the taxation of congested areas. A European unemployment insurance scheme could lead to redistribution effects between countries with a high and low rate of employment and even - depending on its form - between highly paid and low-paid employees[2]. Earmarked financing is also involved in the case of a tax on urban concentration, which might be levied in the form of, say, a land-value tax, a settlement (ie location) tax or a payroll tax graduated according to the density of population, the proceeds from which could if necessary be used for a policy of decentralization[3].

Within a system of vertical distribution of revenue the distribution of fiscal jurisdiction is associated with the determination of vertical adjustment of revenue and the degree of Community autonomy in relation to revenue-raising jurisdiction and revenue-planning jurisdiction. The lowest degree of Community revenue autonomy is associated with allocations (financial contributions) from the bottom to the top. The highest degree

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1) For the basic methods of international horizontal fiscal adjustment see G. Hilber, "Horizontale Finanzausgleichsbeziehungen zwischen Nationalstaaten" (Relationships between nations in horizontal fiscal adjustment), Frankfurt 1974, p 26 et seqq and particularly R. Mathews, "Finanzausgleichsmechanismen in einer zusammenwachsenden Europäischen Gemeinschaft" (Mechanisms of fiscal adjustment in a converging European Community), MacDougall Group, Vol II, p 423 et seqq.

2) See Marjolin Report, Annex, p 1 et seqq and MacDougall Group, Vol II, p 410 et seq.

3) See D. Biehl, U.-A. Münzer, "Agglomerationsoptima und Agglomerationsbesteuerung - Finanzpolitische Konsequenzen aus der Existenz von Ballungsgebieten" (Concentration optima and taxes on concentration - the effects on financial policy of the existence of congested areas), appearing in Forschungs- und Sitzungsberichte der Akademie für Raumforschung und Landesplanung (Research and Conference Reports of the Academy for regional research and land planning).

of revenue autonomy for the Community would be in a divided system, in which the type of tax, the basis of assessment and the rates could be determined by the Community. European taxes levied direct by the Community would be characterized by the fact that, among other things, the taxpayers would be natural persons and legal entities and not countries. Autonomous taxation of this kind by the Community presupposes greater involvement in the national tax administration because in that case the Community could no longer approach the member countries for payment of the taxes with legally binding effect.

Between these two extremes lie the basic possibilities of the vertical distribution of revenue. As there has so far been no type of revenue, with the exception of customs duties, price-adjustment levies and sugar duty, for which legislative jurisdiction and revenue-raising jurisdiction rested with the top level and the initiation of a more central revenue autonomy for the Community is, as has been shown, very difficult and often only theoretically possible, Community expenditure will probably be financed by means of a tax-sharing system (quota or pooling system) or by a surcharge system (tax-overlapping) (see Diagram 1)[1].

Tax-sharing is technically possible if all the Member States use the same basis for assessment to tax. If the rates of tax were also harmonized a formula could be used to share the total tax yield between the "Fourth Level" and the member countries.

Financing by means of a surcharge system, involving competition for the same source of tax, would be characterized by greater autonomy for the Community which could be put into effect by making the European Parliament the legislative authority. Certainly, a "Europe surcharge" presupposes a

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1) The MacDougall Group (Vol I, p 507 et seq), makes a distinction between tax-sharing, ie distributing tax yield over different levels, and tax-overlapping; for the establishment of a tax-sharing system see also H. Zimmermann, "Fiscal Federalism in the Federal Republic of Germany, Paper delivered to the Advisory Commission on Intergovernmental Relations", Washington DC, February 1978, pp 14 et seqq and 44 et seqq.

harmonized basis of assessment. In this case the "Fourth Level" would apply its own rate of tax to the assessment; the rate of tax could be at the same or different levels for the various Member States, say according to their ability to pay.

What we have said makes it clear that whether tax-sharing or the surcharge system is applied in the Community, it is not a matter of individual taxes but of different opportunities to appropriate yield from certain taxes or of transfers of part of the tax yield of the member countries.

In this connection if the economic, technical, legal and integrational criteria are examined on the basis of the financing proposals, it is clear that their importance depends on the form of fiscal adjustment selected. The criteria of perceptibility and the lack of effect on competition gain importance if a surcharge system or a special European tax is substituted for tax-sharing. The use of a given item of revenue as an instrument of cyclical policy depends partly on the stage of economic and political integration reached. Thus the assessment criteria are given an importance which is affected by the desired form of fiscal adjustment and it becomes clear that financing proposals and criteria cannot be compared without interposing fiscal adjustment.

This relationship is implicit in the demand for own resources (Article 201, Treaty of Rome), although the "own resources system" is not laid down in law. According to the Commission's "ideas on institutions", the feature of own resources is that they "are of a fiscal nature to be raised direct from individuals or businesses in the Community and are not subject to the decisions of the Member States. ... The resources are not part of the revenue of the Member States and need not be shown in the budgets of the Member States or approved by their parliaments"[1] [2].

Although the own resources system has been given definite form by the Commission, the fact that fiscal adjustment systems and financing proposals are being discussed at the same time is likely to produce contradictions. Thus while the Commission demands Community taxes, it specifies them in the form of a larger share of the value-added tax, to which the characteristics of "own resources" as defined by the Commission itself do not fully apply. It would be necessary to remove the remaining exceptions to the harmonized basis of assessment; furthermore the calculation procedure according to Method A, which allows a method of levying independent of estimates of the assessment basis, would have to be generally applied[3]. Finally, in its Memorandum the Commission demands Community taxes but at the same time makes concrete proposals for three forms of tax-sharing (an increase in the rate of VAT and transfer to the Community of part of the cigarette and petrol duties)[4].

II. Assessment of certain financing proposals

As a discussion of all proposals on the basis of all the criteria would be too lengthy and complicated, weighting will be applied. The proposals which have a lower priority against the background of the criteria developed will be dealt with rather briefly so that the alternative shown may be given greater emphasis.

1. Proposals tending to have a lower priority

The problem with the individual excise duties is that on their own they would not be sufficient to cover financial needs. Their primary

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1) Financing the Community Budget - Future method, EEC Bulletin, Supplement 8/78, p 17.

2) In the view of the Commission these requirements are only fulfilled in the case of customs duties and price-adjustment levies.

3) See G. Spanakakis, "Mehrwertsteuer-Eigenmittel für die EG" (Value-added tax, own resources for the Community), IFO Express Service, Vol 32, 17 April 1979, p 9 et seqq; this paper shows, among other things, how differences in tax "morals" and the efficiency of the tax administration may affect the distribution of burdens.

4) Some other term such as EEC tax or European tax (Community Tax) would be clearer than "Gemeinschaftssteuer" because in German usage the term "Gemeinschaftssteuer" is used if the tax yield in a tax-sharing system is available to several territorial authorities. This meaning of the term is not, however, intended in the passage quoted.

potential use is for certain non-fiscal purposes, but even then they do not fulfil the requirements mentioned. The use of excise duties is on the one hand made difficult because there is not always a harmonized basis of assessment, which is a technical prerequisite, and on the other hand they raise the problem of different national consumer habits and thus the difficulty of achieving the aim of regional redistribution. If the consumption of certain goods, say coffee, wine or beer, is particularly high in countries with a low GNP, there will be problems of distribution which are likely to make political union more difficult from the outset. A tax on tobacco, especially on cigarettes, can be justified for health reasons but would lack credibility - as it does now in the Member States - if the tax were levied in the hope of fiscal gain.

If it is true that there is a long-term correlation between national consumption of energy and national capacity in the Member States, there would be an opening for a European tax on energy. National energy consumption (eg of light and heavy oils or electricity) could be used as a basis for assessment. Ideas could be defined more closely for the case of a tax on petrol or oil, part of the proceeds from which - if no surcharge right is granted - could be made available to the Community. Depending on the extent to which the different excise duties were appropriated nationally to fiscal purposes, eg were earmarked for some specific purpose, there would be problems of adjustment if tax-sharing were adopted.

Financing by means of tax deducted from wages or income tax has not so far been discussed either on the basis of national income tax or as a supplementary Community income tax with a separate basis for assessment. In the former case there are insuperable problems of harmonization, whereas in the latter case, apart from defining the basis of assessment, the relationship between the two taxes would have to be clarified. There is also the question of whether the European tax can be counted towards the national income tax.

A European tax on corporations is a source of finance which has frequently been mentioned but seldom examined in detail[1]. Here again, in spite of existing groundwork for European company law, the need for harmonization is relatively great, so that for the present it must be eliminated as a means of financing for reasons of time. In the long term there are a multitude of questions, such as whether national corporation taxes and a European corporation tax should be complementary or substituted one for the other and the associated problems of coordinating tax rates, tax deductibility, etc. From the fiscal angle it would be necessary to examine whether a yield corresponding roughly to the 1% rule in the case of VAT could in fact be raised by all the member countries under existing tax law and whether in some countries there would be a risk of eroding the basis of assessment. The time required for harmonization cannot be overestimated because balance sheet disclosure, valuation and depreciation, for example, are handled in different ways in different countries. A surcharge on existing rates would have to be very high to produce a good yield.

A more realistic proposal, therefore, is that of a supplementary European corporation tax which could be counted towards the national corporation tax. To avoid the problem of different legal forms, some kind of company or business tax would be needed, which would then count towards corporation or income tax. But even in this case there would be further questions about the number of taxpayers, the fiscal yield and

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1) From the point of view of tax harmonization, however, see B. Schendstock, "Harmonisierung der Besteuerung von Kapitalgesellschaften und von Dividenden" (Harmonization of the taxation of joint stock companies and dividends), Annex F, Steuerharmonisierungsbericht des Steuer- und Finanzausschusses der EWG (Report of the EEC Tax and Finance Committee on tax harmonization), (Neumark Committee), loc cit, p 141 et seqq, and more recently "Harmonisierung der Körperschaftsteuer" (Harmonization of corporation tax), Community Bulletin, Supplement 10/75.

the amount of administrative work involved if companies had to comply with both European and national corporation tax law. In the case of direct taxes, which would fulfil many of the conditions of a European revenue system, answers can only be expected in the long term because harmonization is particularly time-consuming owing to greatly differing national tax policies in this field.

2. Increasing the proportion of value-added tax versus introducing a "national product tax"

Increasing the rate of value-added tax seems particularly obvious, as the requirements of harmonization will be completed in the next few years after years of conversion work relating to the basis of assessment, and there is a time limit to the remaining anomalies. Early agreement to the 2% solution may, however, come up against the wish of member countries first to gain experience of the new form of financing and the method of calculation. Moreover, for some countries (eg the United Kingdom) raising the rate means a substantial loss of national yield from value-added tax and therefore a special limitation of national tax autonomy[1]. In the short term Community autonomy will be strengthened only in connection with revenue-raising jurisdiction, and perceptibility to the taxpayer will be increased by the financing procedure only indirectly, particularly if the total national burden of taxation rises. The federalistic structure of the Member States will only be affected where - as in the Federal Republic - the national yield from value-added tax is divided between territorial authorities. The greatest objection to the value-added tax solution, however, is that it fails to achieve the declared objective of regional

1) There might well be a case where the national yield from a tax is insufficient to cover the European share. This is unimportant so long as the basis of assessment is used to assess financial contributions (charges); if, however, own resources are involved, or a direct demand on the taxpayer, there will be additional problems. See also D. Dosser, "A Federal Budget for the Community", Federal Solutions to European Issues, London 1978, p 103.

redistribution. If the regressive effect is to be avoided it is necessary either to ensure a balance by means of other types of revenue or to give the value-added tax rule a suitable balancing mechanism which will limit or avoid its regressive effect. Any such attempt would undoubtedly lead to distribution struggles between the countries, which would do anything but encourage integration. Another disadvantage is the relatively small measure of elasticity in the yield from value-added tax and the high costs of collection[1].

Use of value-added tax as the chief source of finance also interferes with later opportunities to use the revenue of the Community budget in the interests of stability. This objection gains weight if, from the point of view of growth or distribution, Community expenditure is classified as "above the trade cycle"[2]. In view of the numerous disadvantages of the value-added tax arrangement we must finally ask how its further development in the own resources system will affect newly joined countries and what the effect will be of differences in tax administration and the tax fraud quota.

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1) In this connection it may be mentioned that the Neumark Committee - though not in the context of financing the Community budget - recommended a narrower basis of assessment for harmonization, "Steuerharmonisierungsbericht des Steuer- und Finanzausschusses der EWG" (Report of the EEC Tax and Finance Committee on tax harmonization), loc cit, p 42 et seqq, also D. Dosser, "A Federal Budget for the Community", Federal Solutions to European issues, loc cit, p 106; Dosser takes the view that narrowing the basis of assessment for the new member countries would mean a considerable simplification.

2) In this connection we might also consider Oates' proposal to make value-added tax an instrument of European cyclical economic policy. His proposal presupposes greater taxation powers, in the sense of a change in the tax rate for the Community, and is the subject of much discussion as to how it would work - all technical and legal conditions being fulfilled. If Oates' view is not shared even in the case of different rates for certain classes of goods (for example, luxury goods and the necessities of life) all that is left is the visual effect, or the visibility of such measures for a coordinated policy of stabilization. See W.E. Oates, "Finanz-Föderalismus in Theorie und Praxis: Lehren für die Europäische Gemeinschaften" (Fiscal Federalism in Theory and Practice: Lessons for the European Communities), MacDougall Group, Vol II, p 300 et seq. But see H. Haller, "Die indirekten Steuern als Instrument der Stabilisierungspolitik, insbesondere einer solchen zur Konjunkturdämpfung" (Indirect taxes as an instrument of stabilization policy, particularly of a policy intended to curb excessive economic activity), Schweizerische Zeitschrift für Volkswirtschaft und Statistik (Swiss Journal of Economics and Statistics), No 4, December 1978, p 735 et seqq.

In spite of the fact that a share in value-added tax does not meet all the requirements of European revenue, it will probably nevertheless be used as a financing instrument, because increasing it to a higher percentage is administratively easy; after the relevant resolutions of the Council and the European Parliament all that is required is ratification of the increased rate by the Member States and it does not change the existing system of vertical adjustment of revenue[1].

As the national product has been recognized as a "fair" indicator of the national capacity to pay, at least since the United Kingdom renegotiated entry to the Community, the movement away from the national product as an indicator of capacity to pay and the change to value-added tax financing seems, with hindsight, to be unfortunate[2]. It is therefore proposed that instead of increasing the share of the basis for assessment of value-added tax there should be a change in the basis of assessment in favour of the GNP_M. At the same time the Communities should be able to fix the share of the new basis of assessment freely and without an upper limit. Under this proposed revenue system, with autonomy of rate for the Communities, the member countries will still be liable to tax. We have at the same time both a type of overall sharing system, as the funds are derived from the revenue of the member countries, and also, because of the power to fix tax rates ("rate jurisdiction"), an earmarked divided system.

Regardless of which national product value is selected, there is no need for harmonization in the determination of a basis for assessment in view of the existence of agreed figures produced by the Statistical Office of the European Communities relating to taxation, valuation and definition. The "Eurostatistics" contain a number of definitions of national product (gross domestic product, gross national product, disposable income, etc) and all that is needed is a decision as to which of these values shall be used as a basis[3].

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1) It has been calculated that from the fiscal point of view a 2% arrangement to the end of the 1980s would be sufficient only on the assumption that with slight economic growth there would be no additional expenses arising on enlargement of the Communities and that no further fiscal obligations would have to be undertaken in association with an economic and monetary union. "Financing the Community budget - Future method", Community Bulletin, Supplement 8/78, p 19.

2) See also G. Denton, "Reflections on Fiscal Federalism in the EEC", Journal of Common Market Studies, Vol 16, No 4 (1978), p 299.

3) But see Section B IV, 2.2.1.2, also MacDougall Group, Vol II, p 457 et seq

If the gross national product at market prices is chosen as the basis of assessment this proposal would also meet the other technical criteria. An adequate yield is guaranteed by the elasticity of the revenue and the autonomy of the Communities regarding rates; similarly levying and transfer do not present any problems. The national federalist structure and tax policy are affected relatively little because there is no competition for the same tax revenue. Perceptibility and cheap payment are not yet in the forefront in this type of vertical revenue distribution. Recourse to the individual taxpayer is not yet envisaged in the context of this proposal.

The economic criteria can also all be met, This proposal stems from a regard for the national ability to pay; redistribution between regions can be achieved by means of an above-average burden on the countries with a higher per caput income. Rate autonomy would make it possible to achieve economic objectives in conjunction with operations relating to debts. Moreover, use of the nominal GNP produces effects in connection with price movements in the member countries, although these must be considered in conjunction with the time-lag - sometimes for technical reasons - in the basis of assessment. Arguments relating to competition drop into the background in the case of "national product tax".

The objections to this simple proposal for financing are concerned on the one hand with legal and integrational aspects and on the other with doubts as to the tax system. The crux of the latter is that this proposal takes no account of existing tax structures. Objections on the integration side are that there is no individual tax-sharing, nor is a surcharge system introduced. An argument against the claim that the proposal fails to meet a criterion of the own resources system mentioned by the Commission - namely that the "national product tax" would not be paid directly by individuals and businesses - is that this is not, or is at any rate partly not, the case with the value-added tax proposal put forward by the Commission. Moreover, the national product solution does not eliminate the possibility that other types of revenue, for example individual tax-sharing in the case of mineral oil tax, could be used. In the long term a "revenue system" will emerge, particularly if the disadvantage of one type of revenue is outweighed or financing the Community at any time solely by excise duties is avoided. The consequence of this proposal is greater revenue autonomy for the European Parliament, ie the system of vertical distribution of funds would move a step forward towards a federal solution. The European Parliament would not be so strengthened by development of the own resources system if the share of value-added tax were increased.

III. Strengthening budget control as a condition for the future growth of revenue

For a continuing development of the revenue system towards integration the mere absence of obstruction to further integration in potential additional sources of revenue is not enough. Even if it is borne in mind that in the medium term Community revenues can be used to perform tasks outside the fiscal sphere as well, the future planning of revenues requires further strengthening of the institutions controlling the budget. This applies not only to the financing of future tasks, but also to the debated budgetarization of the Coal and Steel Community and the European Development Fund. Budgetary integration would also bring changes in revenue and in the fiscal adjustment system if the production charge of the Coal and Steel Community was communalized. In strengthening budgetary control we must not think only of the European Audit Office[1] but more particularly of the authority of the European Parliament, particularly as regards the control of expenditure. Even if the budgetary rights of the Parliament have in the past been increased in respect of the expenditure side, this must not blind us to the fact

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1) See C.-D. Ehlermann, "Der Europäische Rechnungshof" (The European Audit Office), Baden-Baden 1976.

that increasing powers have been concentrated in the Councils of Ministers and the Council of Europe and that this development has also prejudiced the position of the Commission[1]. The direction to be taken by this development[2] and whether, in addition to the control of expenditure, it will also lead to greater revenue autonomy (the right to authorize taxation)[3] will ultimately be decided in the political argument as to the future part to be played by the organs of the Community in the context of the federal and confederal financial constitution described in detail at the beginning of this paper[4].

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1) On this political appraisal see E. Klepsch, E. Reister, "Der europäische Abgeordnete" (The Member of the European Parliament), Baden-Baden 1978, p 19, and from the point of view of political science, V. Herman, J. Lodge, "The European Parliament and the European Community", New York 1978.

2) See also E. Grabitz, "Das Europäische Parlament vor der Direktwahl" (The European Parliament before the direct elections), Integration, No 2/79, p 47 et seqq.

3) In this connection see the discussion on a new Article 201 of the Treaty of Rome on future funds, 1974/75.

4) See p 8.