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Leen, A.R.; Kalaitzidis, D.

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THE REVENUES OF THE EUROPEAN UNION: PAST, PRESENT, AND FUTURE

Auke R. Leen

Leiden University, The Netherlands

Department of Tax Law and Economics

E-Mail: a.r.leen@law.leidenuniv.nl

Abstract. The European Commission wants to reform the EU budget. New own resources are high on the wish list. The article gives the rationale and the historical background to the debate on the reform of the EU budget and discusses the proposed new own resources from the point of view of the relevant theories. Theories that are suitable for the EU as it has grown to be. The current debate is plagued by too many *ad hoc* assessment criteria; a systematic onset is desirable. The *status quo* of the current budget is, from the point of view of the legitimacy of EU policies, not that bad. Only seigniorage, the monetary gain from the creation of money that flows to the ECB, comes into account as a new own resource.

Keywords: EU budget reform, Eurotax, seigniorage

Introduction: *Ceteris paribus*, the own resources of the EU

In 2007 the European Commission (2007) launched a public consultation on the future of the budget of the European Union (EU). The wrangling over the current budget, which covers the period 2007-2013, was the straw that broke the camel's back. Citizens, scientists and politicians could give their opinion (European Commission, 2008). After last year's leaked concept, this autumn the final report of the Commission will be published. Based on the report, the institutions of the Union will discuss the ideas and reach a final verdict. In that report, given the results of the consultation, the Commission certainly will discuss new possible means of income for the EU. What are the likely candidates for new own sources of revenue and what are we to think of them?

To talk only about a reform *sec* of the income is almost impossible. If somewhere everything is connected with everything, it is when speaking of the EU budget. That is why in its leaked concept the Commission (2009) speaks of the need for a 'package approach': 'reform of the budget is a matter of one single decision.' An unbalanced and inequitable expenditure site of the budget, as perceived by some, will lead to cuts in the revenue site. Conversely, it is also stated that if citizens know that the funds go to genuine European public goods, they would support a European tax (Iozzo cs, 2008). Though on the other hand it is also stated that because taxes are never popular, a tax will weaken the support for the EU (Mutén, 2001). Also income and expenditure do not give the total picture. The, in 2001 increased retention from 10 to 25%, which

Member States do make on received custom duties, has nothing to do with the real collection costs. The correction is the result of the by the Commission's damned *juste retour* thinking (Heinemann et al, 2008). The revenue side of the budget can only be understood by looking at the past. Revenues are the result of an often *ad hoc*, political compromise. Margaret Thatcher's 'I want my money back,' from the meeting in 1984 at Fontainebleau is one of the best-known examples thereof.

The structure of the article is as follows. After giving a brief history of the own resources and their size, we look at the reason behind the quest for a new own resource. Then we discuss the proposed alternatives and the assessment criteria used. Subsidiarity and proportionality are emphasized as the legitimate criteria of all new own resources. The article gives two ways on how to supplement the EU with new own resources that both do satisfy the legitimate basis of the current *status quo*.

The history of the own resources

What does the EU considers its own resources? There is no definition of own resources. There is only stated how to make a decision about them. For a decision unanimous agreement by Member States is required as well as the consent of the parliaments of the Member States (Art. 311 Consolidated treaty, 2008; cf. Pietas, 2008). It is true that already in the Treaty of Rome in 1957 it was intended to be temporary that the EU was to be financed by national contributions. Full funding from own resources was the goal (European Parliament, 2007). Just as the European Coal and Steel Community, the forerunner of the EU, had her own resources --- and tax collectors. Levies on coal and steel accounted for essentially the costs of a small administration.

In 1970, the own resources, what are now called the traditional own resources, are taxes on agricultural products (now mainly contributions from sugar producers) and taxes on imports. They do not contribute that much anymore to the EU budget, compared to the increased spending of the EU and after the worldwide abolishment of much of taxing imports. They are only 14% of total EU income. Next to a contribution based on the VAT (11%) a contribution based on the size of the GNI (76%) is the lion's share of EU income. Since 1988 there is a ceiling placed on the size of the total income of the EU. Today the ceiling is at 1.23% of GNI of the EU. Because no money can be borrowed, the ceiling also gives the height of the expenditures. For 2010, the EU has a budget of around 140 billion Euros. The VAT-based contribution does not have much to do with the direct VAT revenue in a country. In order to compensate for the regressive nature of taxing consumption, the base to calculate the contribution is set on 50% of the GNI of the Member States. With all the later adjustments and rebates the VAT contribution has become a statistic figure based on the GNI of a Member State (European Commission, 2004).

Why are new own resources necessary?

Given the history of the EU we can be satisfied with the situation of the own

resources as has been described. The EU is assured of a steady stream of income and the collection costs are almost zero. Bearing in mind the motto on the title page of Alfred Marshall's *Principles of Economics*, 'Nature does not proceed by big jumps', we can be satisfied with incremental change. Why is there still a reform of the income of the EU needed?

The EU feels that with the current system of income it has to beg for it at the Member States. The EU wants greater autonomy *vis à vis* the Member States. Moreover, establishing a budget requires endless bickering by the fair share thinking of the Member States. A way to approach to the budget that is more or less the natural result of the current system of direct national payments to the EU. It is not the case that we do answer the question: What will the EU achieve with its spending? It is the answer to the question: What do we as a country give and what we as a country get in return? A real own resource can be a solution to this problem.

With a genuine own resources we do not only give more autonomy to the EU but also to the changed status of the EU. For the President of the European Commission, Jose Barroso (2009, cf. Schüssel, 2007), the EU is more than a cooperation between states like the United Nations. The EU has evolved into a relation between states and citizens. A direct contribution of citizens to the EU is part of this (Brehon, 2005). It creates a bond, a feeling to be one. But that is exactly what makes talking about a European tax so emotionally charged. Supporters and opponents of a federal or looser cooperation fight their battle in their choice for or against a Eurotax (Belafi 2006).

An important argument for reform is also that the EU wants to implement policies that do really matter in these times. The Commission refers to activities with high added value. The Commission (2009) does have three priorities: sustainable growth and employment, climate and energy and Europe as a global player. A budget that largely consists of agricultural subsidies and redistribution is no part of that. Environment, research and safety are tasks that the EU should regulate based on economies of scale and external effects. Thus, the Commission says either the budget must be raised or the existing budget should be reallocated. And if the budget should be raised, we need new (own) resources.

The current method of funding is clearly inadequate for citizens to follow up on the EU and call the EU to account. If somewhere the criteria of visibility, simplicity and equity do not apply, it is at the budget of the EU. Especially the levy based on the VAT is a thorn in the eye of the Commission. A contribution which, with its adjustments and special arrangements, has become completely incomprehensible. This own resource should be the first to disappear as the two-step roadmap of the European Parliament (2007) and the Commission (2009) envisages. The first step is that the payment based on the VAT is removed. The remittance on the basis of GNI should initially be retained. With, however, a uniform adjustment mechanism for clearly unfair net payment positions. The unique position of England re its rebate on its contribution to the EU disappears. Next, as a second step, a new own resource should be introduced.

The proposed new own resources

What are the requirements which the Commission (2009) in its draft report proposes

on a new own resource? It should preferably be related to or following from an EU policy. Just as this is true also of the current traditional resources. Further requirements are that it must be EU territory wide, must have a harmonized basis and the total tax burden of citizens must remain the same. In line with these requirements, options are stated that do often already have a long history on the wish list of the EU (Cattoir, 2004, European Commission, 1998).

Under the proposed resources, some, such as a tax on personal and corporate income, do require a long preparation period; the tax base must first be harmonized. Not all Member States do account for income or profit in the same way. Before the introduction of the VAT based contribution, the harmonization of the base did last from 1970 till 1980. The problem, however, can be circumvented, see below, through a declaratory tax.

For taxes that can be introduced on a short term the EU looks for taxes on consumption, transport and communication. In particular, the EU thinks about a direct payment of a portion of the VAT to the EU: on each bill the payment to the EU is visible. Other proposed taxes are an excise duty on tobacco, alcohol or on car fuel, seigniorage, and taxes on energy, communications, financial transactions, climate and aviation.

Often the forms of taxation are known alternatives that are just fitted in a modern jacket. What is also their weakness. Originally for a communication tax the EU wanted to tax fixed telephone lines. Now the EU does speak of taxing text messages and e-mails. European Parliament member Alain Lamassoure and chairperson of the budget committee of the EP is thinking of 1.5 cents on a text message and 0.00001 cents on every e-mail. But who can predict how we, in a number of years, will communicate? Similarly, it goes for the proposed tax on CO₂ emissions. What if we do discover that global warming is not happening.

Co-financing

Though co-financing is a reform on the expenditure side, the greater use of this policy has also the aim to release funds for new policy areas. Given the experience in the U.S., it is questionable whether this, especially the partial re-nationalization of agricultural expenditures, will have the desired results. In the U.S. co-financing is for individual states an incentive to an acute gold rush. This since the federal government is paying too. There are expenses incurred that would otherwise never have been done. Democratic control of the lender is far less direct. Ineradicable abuse is the result: the individual states uses taxation to drive up the costs of a project, though later the taxes are mostly given back to the applicants of the subsidy. The effect is that the total amount is higher and thus the co-financing by the federal government too (Edwards, 2005).

A declaratory EU tax: the egg of Columbus?

In a declaratory tax (Caesar, 2001) a Member State still pays a direct contribution to the EU. It, however, shows the amount clearly as a percentage of, e.g., the VAT on the receipt to the customer or as part of the income tax most citizens do pay. The

amount is linked *pro forma* to a certain tax. Harmonization of the tax base between countries is not necessary. Each country chooses its own 'EU' tax. Since each Member State has its own preferred way of taxation, this is, from the point of federalism, an advantage (Heinemann et al, 2008). Moreover, there are no additional collection costs and the tax is sufficient and stable.

But there are also disadvantages. Since, e.g., in countries the rate of progression in income taxation is different, citizens, other things being equal, do pay different amounts for the Eurotax. There is no horizontal equality. Also, the taxpayer in a sense is misled. The payment is still done by the country and the autonomy of the EU seems bigger than it is. Moreover, it can function as an unwanted precedent. For other goals too there can be asked specific contributions; the decision freedom of the government on general tax revenue is curtailed.

Criteria: too much to handle

What are the assessment criteria of the proposed new own resources? The following are often mentioned by Commission (1998, 2004, Begg et al, 2008) and EP (Doherty, 2007): visibility, simplicity, financial independence, efficient allocation of resources, sufficient income, cost effective, stable income, equity and added value for Europe. Often they are summarized in the groups: budget criteria (adequacy/ stability); efficiency criteria (visibility / low collection costs / efficient allocation); fairness criteria (horizontally and vertically between individuals and countries) (Cacheux, 2007; Cattoir, 2004; Raddatz and Schick, 2003).

In addition, often explicitly political criteria are added (Rubio, 2008): acceptance by Member States and consistent with the subsidiarity principle. Each Member State will in case of a change in its contribution make an assessment: what do we gain compared to what do we lose. It would be illusory not to take this into account. Since a new own resource strengthens the influence of the EP and diminishes the influence of the Council, both will base their position partly on that fact too. In EU reports, we often find not only the criteria but they are also qualitatively or quantitatively weighted. Points are distributed between the several options and a final assessment is made (EP, 1997; Beg, 2007; Beg et al, 2008).

The multitude of criteria is a problem. As former Prime Minister of the Netherlands, Wim Kok, said about the Treaty of Lisbon: 'Lisbon is about everything and therefore nothing. Everyone is responsible so no one actually is.' For a rational principled discussion, the EU has to come to a manageable list of criteria. Without it, the choice is the result of an *ad hoc* policy of what is politically possible: the result of strange compromises in the late hours of the evening. A rational choice requires a systematic approach based on the explicitly stated and relevant theories. Heinemann et al. (2008, cf. Figueira, 2008) gives an attempt of this approach. The criteria are reduced to four theories: fiscal federalism, public choice, European integration, and the traditional principles of taxation.

The theory of fiscal federalism looks at the efficient provision of public goods and how to provide an opportunity for heterogeneous tax preferences in the Member States (cf. Menéndez, 2004). Regarding the lessons of the public choice theory, it is clear that the EU is at the wrong end of the spectrum of efficiency and effectiveness

with regards to money. Spending our own money for our selves is mostly done in an efficient and effective way. Spending other people's money for someone else is clearly another thing. Within a relatively homogenous culture as in the Netherlands this can be done, however in the EU it is a problem of an entirely different order (Friedman 1980). The, as they are presently known in the US, 'bridges to nowhere', are legendary and of all times. Thus in 1999, the European Commission led by Jacques Santer, also resigned on grounds of corruption allegations. The integration criterion requires the mitigation of the struggles between nations and the avoidance of a negative attitude of citizens to the EU (cf. Cacheux, 2009).

The theories, unfortunately, do not fit nicely together. So with the advent of the multi-annual budget, as the Commission (2009) also experiences, the transaction costs are reduced to combat conflicts between States. The traditional criterion of an efficient allocation of resources, however, is the victim. This since during the fixed budget period, as the present EU budget is fixed from 2007-2013, the often necessary policy changes are very difficult---as is shown clearly in the present credit crisis.

Seigniorage

The low hanging fruit of the to the EU attributable revenue, the traditional own resources, has been harvested. Given the problem, though solvable, that only part of the Member States do have the euro, there is only the seigniorage to add as a new own resource. Seigniorage is the monetary gain that flows to the ECB for the creation of the Euro. Though for this policy too, the transfer of seigniorage to the EU, there are winners and losers. For the Netherlands, the decline is approximately 10% compared to a proportional payment as a percentage of GNI (Heinemann, 2008). The payment would be almost neutral in relation to profits that used to flow directly to the national central bank before the introduction of the Euro (Sinn and Feist, 2000).

It is estimated (European Parliament, 1997, Begg, et al. 2008), that this resource can cover about one third of the EU expenses. The growth of the use of the euro outside the EU as such would also be of benefit. Just as for the U.S. where half the number of circulating dollar notes, about 3 percent of GDP, do circulate outside the U.S. (Baldwin and Wyplosz, 2006). Besides the disadvantage of stark fluctuating income ---another name for seigniorage is inflation tax --- it has the disadvantage that because of the worldwide decline in cash payments it is not exactly what we would call a form of taxation that has the future. Also there is no question of the desired direct link by the EU between citizens and the Union. There is even the danger that the ECB would be put under pressure by the EP to generate extra income.

The benefits of the *status quo*

A condition every reform as a prerequisite has to meet, and the current system does, is legitimacy: the criteria of subsidiarity and proportionality (Art. 5 Consolidated Treaty). A requirement of legitimacy that often for other European policies is only a hollow form of rhetoric (see Ederveen et al, 2006). In this way the fiscal sovereignty of the Member States is guaranteed.

At the present *status quo*, tax measures are taken at the lowest possible level and do not go further than is necessary. That is a big advantage. A UK study (Gaskell and Person, 2010) after the cost of regulation shows that, though difficult to measure and to compare, own British regulation is 2.5 times as effective as regulation done by the EU. EU regulation often costs about as much as it actually accomplishes. This counts for policy areas where the EU and UK share responsibility, such as social policy, financial services, environmental and consumer protection. The difference in result can presumably be attributed to the fact that EU legislation is a one size fits all and difficult to adjust by the requirement of unanimity in decision making.

Fiscal sovereignty: an inclined plane

A Eurotax affects the fiscal sovereignty of Member States. New own resources, in addition to existing traditional own resources, represent a loss in an area closely linked to national fiscal sovereignty. Still, the leap is not as great as it might look at a first glance. We already find ourselves on a slippery slope. Based on his ideas about national sovereignty, the French president De Gaulle until his resignation has always stopped the introduction of the traditional own resources. Only in 1969 did France give in, in order to obtain adequate financing of the European agricultural policy. At that moment, it considered the funding of the agricultural policy of the EU of greater importance. More recently, a loss of national sovereignty took place in an area closely connected with fiscal sovereignty: the creation of money as is nowadays done by the European Central Bank (ECB) (Brehon, 2005).

But there are differences. When paying taxes there is a direct link of the citizens with the government. What the EU of course is just looking at. A link that is missed with the creation of money. It can also be said that the credibility of the ECB is greater than that of the EU institutions in Brussels; the confidence to transfer sovereignty to the ECB is correspondingly greater. In addition, the National Central Banks do play a direct role in the ECB, the interplay of national parliaments and the European Parliament is less direct and harmonious (Negrescu, 2008). Furthermore, the EP and the European Council do miss essential characteristics --- in fact, these characteristics are even blown up --- necessary for rational decision-making on taxation. Often in the EP the national interest prevails above that of the weaker ideological bond in the party. Did all the Greek MEPs and members of the Commission really never know what the Greek deficit really looked like? As it is a fact that what some countries in official documents and the Council do tell is not equal to what they really think, or do give a true picture of the situation (Clasper and Thurston, 2010).

Conclusion

For a cynic the EU budget is the lubricant for closing more important political regulations: the infamous Brussels regulation machine. Albeit it is costly with an amount of 140 billion euro. The EU budget makes compromises possible and is used as a means of increasing the popularity of the EU (Figueira, 2008). For what can be

the problem of a budget of only 1% of GNI? No Member State should have problems with that amount.

If we do take the Lisbon Treaty serious, the plan to reform in a number of steps the own resources is not that bad. The second step, however: to create new own resources, can be dispensed. The first step of a generalized correction mechanism satisfies. The Lisbon Treaty requires with shared responsibilities of tasks of the EU and the Member States that the criteria of subsidiarity and proportionality are to be fulfilled. Both criteria clearly do not allow any new own resources as the ones the EU does think of. Only the quest to a direct link between citizens and the EU, taken as a *sine qua non*, the integration criterion, calls for a Eurotax. Unfortunately the only sensible European tax on the seigniorage of the ECB does not meet that criterion. In a study of the EP (1997) of all proposed taxes seigniorage only got on total zero points, the maximum number of point was scored by a direct payment to the EU of a portion of the VAT.

Moreover, in the above we did not speak of the quality and reliability of the national tax administrations. This is relevant when an Eurotax is chosen. For example, southern European countries, despite the regressive nature, often are not against a direct tax on consumption. Apparently not all VAT is collected which should have been collected; the capping of 50% of GNI in the current VAT levy has its advantages. Just as, of course, the official GNI does not always give an accurate picture (Schneider, 2007).

In short, while an EU tax that meets all the criteria is as illusory as the sheep with five legs, the present legitimate *status quo* with gradual adjustments is not a bad idea. Transferring the seigniorage of the ECB to the EU will do a great deal of the job the EU wants: in some sense, the autonomy of the EU will grow. Taxing seigniorage together with the existing traditional own resources will supply more than half of the EU budget. The direct contribution of the Member States to the EU is substantially lower as before. May be the *juste retour* thinking will be comparable lower too. Who knows?

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