EUROPEAN PARLIAMENT

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Parlamentsdirektion

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Background Note

THE FUTURE RESOURCES OF THE UNION

1. This paper describes the resources of the Union to date, sets out a number of issues concerning the current system, before summarising recent developments in the own resources system and options under discussion with a view to future developments in the Union's finances.

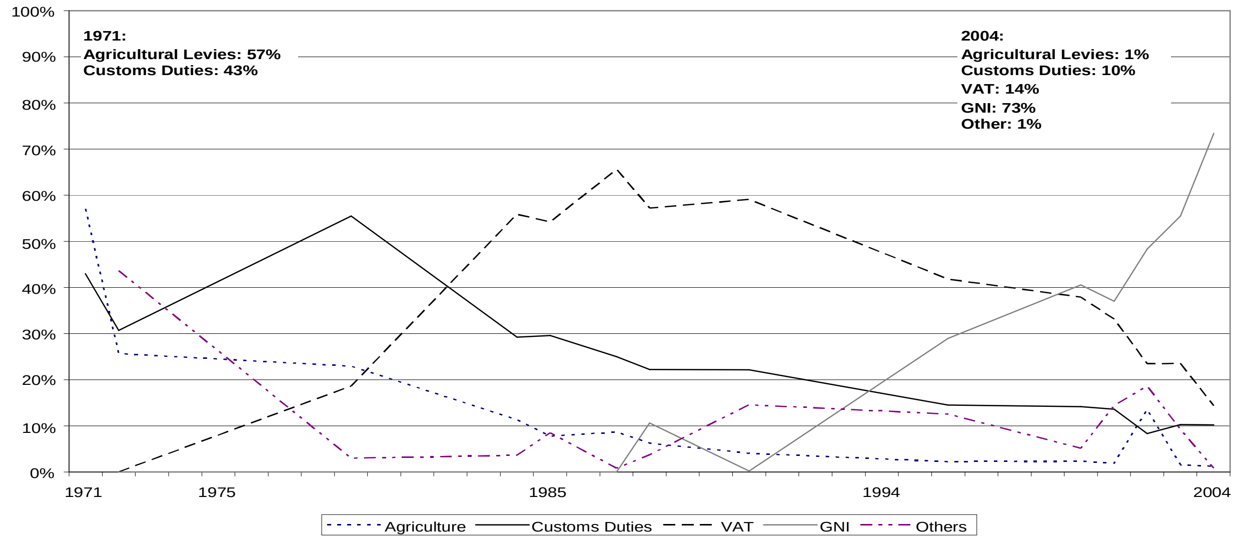
THE RESOURCES OF THE UNION TO DATE

2. The Communities were initially financed by national contributions. Since the Decision of 21 April 1970[1], the Community budget has been financed by own resources, due to the Communities' own right without any further decision having to be made by national authorities. The 1970 decision provided for "traditional own resources" (customs duties and agricultural, sugar and isoglucose levies) and a "VAT own resource" intended to balance the budget. A "fourth resource", based on national GNP, was introduced in 1988[2]. The maximum amount of own resources is currently set at 1,24% of Community GNI.

3. Over time the importance of the share of traditional own resources in the Union's finances has declined significantly as the VAT and, particularly, GNP resources have increased.

[1] OJ L 94, 28.10.1970, p.19.
[2] OJ L 185, 15. 7. 1988, p. 24.

Evolution of the structure of own resources 1971-2004



4. The Decision of 7 May 1985[3] introduced a compensation mechanism which returns to the UK two-thirds of the difference between its share of VAT revenue and its share of allocated Community expenditure (the "UK abatement"). In order to leave total own resources available unchanged, the UK abatement is financed via an additional call-up of funds from the Member States, taking into account a 75% abatement for Germany, the Netherlands, Austria and Sweden.

ISSUES CONCERNING THE CURRENT SYSTEM OF OWN RESOURCES

5. Traditional own resources are expensive to collect and subject to a high risk of fraud and irregularity[4]. Collection of the VAT resource and, especially, the GNP resource costs very little.

6. The share of consumption, and therefore VAT, in national income tends to be higher in poorer countries. Prior to 1988, as the share of own resources coming from the VAT resource increased, own resources appeared increasingly inequitable. Since then, with the introduction of the fourth resource based on national income and successive reductions in the VAT take, own resources have become more equitable.

7. Own resources based on VAT and GNP are transferred to the Union from national budgets. Although they are part of the own resources of the Union, they often appear in national budgets and can be mistakenly perceived as a national contribution, subject to a vote in national parliaments, raising doubts about the financial autonomy of the Union. This also helps foster a focus on the national benefit of membership of the Union in terms of net budgetary balances, rather than on the wider benefits of membership.

8. The move away from traditional own resources to the VAT and, especially, GNP resources has ensured that sufficient resources are available to the Union, in an increasingly equitable and cost-effective way. On the other hand, as the share of own resources coming directly from Member States' public exchequers has increased, the

[3] OJ No C 136, 4. 6, 1985 p. 1.
[4] Financing the European Union, Commission report on the operation of the own resources system, 7.10.1998.

financial autonomy of the Communities and the perception by the general public of the wider benefits of Union membership has declined.

9. Possible reform of the Union's resources has been under discussion for a long time. The European Convention allowed the various players at both European and national level to examine the issue together for the first time. Participants in the discussions on the own resources system concluded that the system for financing the Union should be based on the following principles[5]:

- The principle of transparency: citizens should be able to ascertain the cost of the Union and should be able to understand how it is financed.

- The principle of taxation by consent[6]: the system for financing the Union must be subject to approval and scrutiny by citizens' parliamentary representatives. This is an elementary democratic principle of the rule of law. It is essential that citizens' parliamentary representatives should play an effective part in decision-making on own resources, whether through national parliaments or through the European Parliament[7].

- The principle of adequacy of means: the financing system must enable the Union to attain its objectives. This is the budgetary aspect of the principle already enshrined in Article 6(4) of the TEU: "The Union shall provide itself with the means necessary to attain its objectives and carry through its policies".

- The principle of equity between Member States: the system for financing the Union must be based on the ability to contribute, derived from the relative wealth of the Member States expressed principally in terms of GNP[8].

Views on how to achieve the above differed.

10. Some wished to see the Union's financing system move towards tax revenues. In their view, the stability and transparency of the system would be best secured by European taxes, which should not, under any circumstances, mean an increase in the overall tax burden borne by taxpayers. Those who supported this idea were split between:
    - Those who considered that establishing resources of this kind falls within the sphere of secondary legislation, and that no treaty change is necessary to create a European tax or participate in national taxes, given the political will to do so. They argued that the Union already commanded this type of resource: traditional resources are fiscal in nature, as is the VAT resource;
    - Those who argued for an explicit provision for establishing tax-based resources.

11. Others believed that the current system of resources was sufficiently fair and sound. Some of them would like the GNP resource, which they considered fairest because based on Member States' relative wealth, to play an even greater role in the system. They were against the idea of explicitly allowing for the creation of tax-based resources.

[5] Final report of the discussion circle on own resources, CONV 730/03, 8.5.2003.
[6] One circle member did not agree.
[7] Some circle members stressed the importance of regular participation by national parliaments in the Union's budgetary debate.
[8] Some circle members argued for gradual correction of degressive financing elements. A few said that budget fairness should also take account of redistributive expenditure effects. Some considered it essential to establish a link between economic policy guidelines and budgetary priorities.

12. The European Convention also looked at the decision-making process. Own resources decisions are adopted by Council by unanimity and are subject to national approval (TEC Article 269). In these circumstances, from a purely mechanical point of view, as the number of members of the Union increases with successive enlargements, it is increasingly more difficult to introduce any changes necessary to ensure the funding of the Union.

13. However, the Constitutional Treaty maintained the current procedure for setting the overall ceiling for own resources but allowed explicitly for the creation of new resources and/or abolition of existing resources. Moreover, it introduced qualified majority adoption by Council, after obtaining the consent of the European Parliament, of laws establishing the implementing measures of the own resources system, as long as this was provided for in the own resources law.

RECENT DEVELOPMENTS IN THE OWN RESOURCES SYSTEM

14. Article 9 of the Own Resources Decision (ORD) of 29 September 2000, required the Commission to undertake before 1 January 2006 a general review of the own resources system. The Commission adopted a report on 14 July 2004[9] containing a proposal to replace the current system for correcting negative budgetary imbalances with a generalised correction mechanism (GCM), in order to simplify the system and ensure a more equitable treatment of net contributors.

15. Under the GCM all Member States would be entitled to a correction of net contributions paid in excess of a predetermined threshold. This would act as a safety net preventing any Member State from making excessive net contributions. The corrections would be financed by all Member States according to their relative share of GNI. However, the total volume of corrections would be subject to a predetermined ceiling. If the total volume of corrections exceeded the ceiling, individual corrections would be scaled back accordingly. This would act as a second safety net protecting those not benefiting from a correction against excessive costs of the correction mechanism.

16. According to the Commission's proposal the mechanism would be triggered if a Member State's net contributions exceeded 0.35% of its GNI, in which case 66% of contributions above this threshold would be refunded. The total volume of refunds would be limited to € 7.5 billion per year.

17. The European Council of 15-16 December 2005 decided not to adopt the Commission's proposal for a generalised correction mechanism. It did, however, stress that own resources arrangements should be guided by the overall objective of equity and to this end agreed a number of adjustments to the VAT and GNI own resource contributions of certain Member States. It also agreed the progressive reduction of a limited amount of the UK abatement.

18. The Commission has since issued a proposal to update the ORD in the light of the European Council decision[10].

POSSIBLE FUTURE DEVELOPMENTS IN THE UNION'S FINANCES

[9] COM(2004) 505 final.
[10] COM(2006) 99 final, 8.3.2006.

19. The 2004 Commission report on the financing of the Union proposed in the longer term, in the next financial perspective, replacement of the current system of own resources with a genuinely tax-based system aimed at delivering financial autonomy for the EU and breaking the link between national contributions and receipts and an excessive focus on net budgetary balances and the narrow national interest.

20. The Commission argued that a genuinely tax-based resource would forge a link between citizens and the EU budget, increase transparency and make decision makers more accountable. It proposed to maintain traditional own resources (import duties on agricultural products and sugar levies). However, the majority of the GNI-based fourth resource and current VAT resource would be replaced progressively by resources based on energy consumption and/or national VAT bases and/or, in the longer term, corporate income.

21. It assessed the three options as follows:

- The introduction of a fiscal resource based on road transport fuel would be technically possible in around 3 - 6 years. It would be relatively simple from an administrative point of view as the tax base is already harmonised at EU level by the directive on energy taxation.[11] EU rates below half of the minimum rates set by the directive would be enough to finance half of the EU budget.

- The introduction of an EU VAT rate would be technically possible in around 6 years. Contrary to the current "statistical" VAT resource, it would create a clear direct link between the financing of the EU budget and the citizen and would increase awareness of the costs of the Union. Potential difficulties with this proposal are related to incomplete harmonisation of Member States' VAT systems mainly linked to zero-rated goods. If the effects of zero-rates could be neutralised, the EU rate would have the same impact on comparable consumers across the Union. An EU rate of 1% would be enough to cover about half of the financing needs of the EU budget.

- A fiscal resource based on corporate income would take the longest to implement, both from a political as well as from an administrative perspective. It would need a common consolidated tax base with a minimum tax rate instead of 25 separate national tax systems and a multiplicity of tax laws, conventions and practices. Since revenue from corporate income taxes is significant (with total revenue in the EU currently representing on average 2,6% of total EU GNI), for the needs of the EU budget less than a quarter of that revenue would need to be assigned to the EU.

22. The Study Group for European Policies (SEP) examined the above proposals and further alternative methods for financing the Union[12], including excise duties on tobacco and alcohol, an EU tax derived from individual income taxes, and other taxes such as a Tobin tax on foreign exchange transactions and a kerosene tax (climate change charge on aviation).

23. The European Parliament has called for reform of the system of own resources, with a view to finding a more transparent, cost-effective, simple and equitable system that provides the Union with appropriate resources for the proper formulation of its policies[13].

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[11] Directive 2003/96/EC of 27.10.2003 of the Council restructuring the Community framework for the taxation of energy products and electricity (OJ L 283 of 31.10.2003).

[12] Own Resources: Evolution of the system in a EU of 25, Study for the European Parliament, Study Group for European Policies (SEP), 30.6.2005.

[13] Report on the need to modify and reform the European Union's own resources system, A4-0105/99, 8.3.1999.

As revenue-raising powers go to the very heart of parliamentary powers, the European Parliament has been working in close cooperation with the national parliaments of Member States. Parliament's current own resources' rapporteur, Alain Lamassoure, has sent a questionnaire on the subject to national parliaments[14] and embarked on a series of meetings with them.

24. The questionnaire also addresses further possible options for new resources, distinguishing between supplementary resources that could be raised through European levies such as taxation of the income of European officials, the seignorage rights of the EIB and taxation of the profits of companies opting for the European company statute, and resources raised from national taxes such as excise duties on petroleum products, VAT, tax on company profits and a tax on intracommunity transactions.

25. On 4 April 2006, representatives of the European Parliament and the Austrian Council Presidency reached agreement on the Financial Perspective for 2007-2013. Total spending was set at €866.4 bn for the period, €4 billion higher than the amount approved by the European Council in December 2005. In addition EIB reserves were increased by €2.5 bn and it was decided that funds for emergency aid (€1.5bn) and the solidarity instrument (up to €200 m per year), to be called up from Member States when necessary, should be outside the Financial Perspective. A series of measures designed to enhance financial management were also adopted, including improved execution of the EU budget and reinforcement of Member States' control of shared management programmes. A review of all aspects of the EU budget - both spending and resources - will take place in 2008-09.

[14] The System of Own Resources. Questionnaire for the National Parliaments, PE 364.848, 26.10.2005.