

Presidency Issues Note for the Informal ECOFIN Working Session II

Berlin, 31 August 2020

Own resources: Towards a fit-for-purpose fiscal architecture in the 21st century

The European Union (EU) own resources system has been the subject of discussions for many years. However, the need for substantial improvements on the revenue side of the EU budget has come imminently to the fore in the context of the recent European Council decision on the Multiannual Financial Framework and the establishment of the Recovery Instrument. From a strategic perspective, we have to think about the European Union's external and internal challenges in a changing geopolitical landscape and about the tasks that the Union should fulfil: Which public goods should it deliver for its citizens, and, importantly, how should this be financed?

Introduction: the current system of financing the EU budget

The European Treaties set out that “without prejudice to other revenue, the budget shall be financed wholly from own resources”. Although the term “own resources” suggests a certain revenue autonomy, the EU budget is de facto largely funded by contributions from EU Member States.

There are currently three types of own resources: First, there are “traditional own resources”, which essentially comprise customs duties and which can be identified as the only own resources directly stemming from a common policy exclusively in the domain of the EU. The second type are the VAT own resources, which function through the application of a uniform rate to the harmonised VAT base. Third, there are own resources that are based on the gross national income (GNI) of the Member States, which close the gap to the total volume of the EU budget. Comprising around 75% of the budget, the GNI-based own resources are by far the most important source of funding for the EU.

In contrast to the budgets of the Member States, the amount of the EU's revenue reflects the total volume of expenditure as agreed in the annual budget. GNI-based own resources in particular may be seen as a contribution to the EU which is similar to contributions made to international organisations

by members. Moreover, there is no direct link to EU policies. The case has been made that this system encourages thinking in terms of national net balances (“juste retour”) and fosters the perception of the European project as a zero-sum game.

Financing the recovery package

With the new recovery instrument ‘Next Generation EU’, on which the European Council agreed in July, the Union has now found a unique and solidarity-based answer to jointly overcome the challenges caused by the Covid-19 crisis. This is made possible by allowing the Commission to use the Union’s strong credit rating to borrow the needed funds on the financial markets – an authorisation which is limited in duration and scope.

When looking at the repayments to be made, the question of financing arises. With regard to the next Multiannual Financial Framework, the European Council stipulated that amounts in the EU budget not used for interest payments as foreseen will be used for early repayments, with a minimum amount, and can be increased above this level using proceeds from any new own resources introduced after 2021. In order to also limit Member States’ financial burden in the medium and long term, it is necessary to already explore new sources of financing for the EU budget now. Such sources should generate fresh money and not just shift national revenue to the EU level.

Mandate by the European Council: reforming the revenue base of the EU budget

In July, the European Council agreed to put the revenue for the EU budget on a broader basis. In addition to the “plastic levy”, the concept of which is largely fixed, the European Commission has been asked to submit in the first half of 2021 a proposal for a regulation introducing a carbon border adjustment mechanism and a digital levy. Since no legislative proposals on either of these exist yet, it seems like a good time to discuss Member States’ expectations for new own resources, including the ones also mentioned by the European Council, namely those based on a revised ETS, possibly extending it to aviation and maritime, or the financial transaction tax, for which negotiations on an enhanced cooperation are well advanced.

Possible candidates for own resources should be checked against a set of objective criteria, such as whether the resource is related to EU policies, fairness between Member States, stability in terms of revenue stream and volume as well as efficiency in introducing and managing those resources. Moreover, political priorities at the EU level have arguably so far predominantly been operationalised through spending choices but not via revenue-instruments. Linking EU policies with revenue for the EU could be a new route in the enforcement of common policies while creating revenue which can be described as a true “own resource” for the EU, which in turn can contribute to overcoming the “juste retour” dilemma.

In light of the above, when it comes to financing the EU budget, it seems very plausible to draw on all those stakeholders who benefit most from the EU Single Market. These include, above all, large cross-border companies and financial institutions. A financial transaction tax and a digital levy fit in this concept as well as the introduction of a common corporate tax base that has been under discussion for some time. On the one hand, such projects generally reduce the discretion of national fiscal policy. On the other hand excessive tax avoidance and tax arbitrage cannot be successfully overcome at the level of the Member State alone.

Looking at the broader picture: a case for a new fiscal architecture

Revenue and expenditure are two sides of the same coin. When considering the revenue side, it makes sense to ask what the money should be spent on, which in turn is intimately linked to future priorities and tasks of the EU. In addition to the achievement of certain distributional goals, as has already been pursued in the EU budget, and a short-term crisis response, which is made possible by the recovery instrument, a third area should also be considered more closely: investments in goods and services with an European added value. These could include, for example, the creation of a European border protection system to manage migration flows that benefits all Member States, but of course primarily brings relief to the countries on the outer fringes of the Union. This area also includes better rail, electricity and data networks, which helps Member States to grow closer economically. Finally, it means creating or boosting research institutes and universities with international appeal and thereby ensuring that economically valuable innovations will continue to come from Europe in the future. Common public goods thus comprise infrastructures that provide substantial cross-border benefits and that can be created more efficiently and cost-effectively at the level of the European Union than by the Member States.

Questions for discussion:

- How do you assess the current system of financing the EU budget? Where should reforms begin?
- Which expectations do you have regarding the new own resources to be proposed by the Commission? Do you see additional candidates for new own resources?
- Can Ministers agree to the general principle that resources stemming from European regulations or common policies should be channelled to the EU budget in the future?
- On the EU's fiscal architecture: Should tasks related to EU public goods and corresponding expenditure by Member States be shifted to the European level in the future? Should current expenditure be more closely aligned to the principle of subsidiarity in return?