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Reforming Europe: "EU Shares" as an Own Resource

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Abstract

Over time, the European Union's financing system has attracted its fair share of harsh criticism. On the one hand, it is broadly agreed that the current collecting approach – relying on GNI-, VAT-based resources and other minor funding sources – is particularly complicated. Hence, communitarian policymakers have begun thinking of financing alternatives. Can more efficiency be combined with equity? And what is the most fitting approach to reach this objective? The paper shows that one thing is certain: the near future will be crucial for finding new financing methods.

Keywords: European Union budget, funding methods, alternative resources

1. Introduction, Methodology and Objective

The present paper is conceived as an economic open letter aiming to analyse the potential introduction of a "new" EU resource, which would substitute (part of) the current financing methods. Similar proposals are new, because the so-called "own resources system" financing the European budget has not been significantly reformed since the Fontainebleau summit (European Council, 1984). Leaving aside the historical details, note that the own-resource debate started in 2011 (European Movement International, 2015), when the European Commission not only pleaded for a reform of the financing methods of the communitarian budget, but also suggested introducing a financial transaction tax and a new VAT resource. The Higher-Level Group on Own Resources (HLGOR), established in February 2014, will hence deliver its final recommendations to the European Commission by the end of 2016. That being so, we cannot help looking at:

1. The ways the European budget is financed;
2. How it may be reformed to reflect changing composition and needs.

If the first point is still interesting – especially, should one want to go into the detail of the financing preferences over time (Osterloh, Heinemann & Mohl, 2009) −, the second one is even more relevant, because it seeks to discover new economic landscapes. The approach to adopt is therefore not only theoretical, but it also combines elements of empirical evidence, a crucial aspect in a diversified territory like Europe's. The subject is recent and the scientific debate is far from systematic at this stage. In order to tackle the needs soon to be faced by the European Union, the proper approach should look forward, and be based on own analytical suggestions leading to new results. To put it another way, the ball is in the camp of policymakers, who have to write the future. This is the key reason why economic experts (having intensively debated on the current system) should focus on alternative approaches. And this is precisely what the paper tries to reflect.

2. The European Financing System: Analysis of the Status Quo

Periodically, the debate flares up anew over to which extent European institutions should influence the economic life of member countries. Whether such impact should be direct or indirect, the matter has been subject to extensive treatment. We are going back to 2011, when the plan of a tax reform to finance the European Union was first discussed. What follows is therefore conceived as a brief recapitulation of how the European Union is nowadays financed by its own main contributors and what reform steps can be taken in future. It seems difficult in the European context to ratify any fiscal reform, because changes to the laws regarding the European budget have to be voted unanimously (European Council, 2016). This means that "reformers tend to seek broad consensus above radical change" (Barbière, 2015). At the same time, lacking autonomy of the European budget is another point of weakness. Most resources contributing to the financing of European bodies come from member nations and are defined according to their economic power (although they have been blamed for being subject to *ad-hoc* arrangements): "[t]hose arrangements should therefore ensure, in line with the relevant conclusions of the 1984 Fontainebleau European Council, that no Member State sustains a budgetary burden which is excessive in relation to its relative prosperity. It is therefore appropriate to introduce provisions covering specific Member States" (European Council, 2007). As anticipated, the current own resources system seems to be too complex and to lack transparency (Monti, 2015). In addition, article 201 of the Treaty of Rome (1957) prescribes that the budget shall be financed wholly from own resources. Instead, national contributions accounted for up to 83 percent of the EU budget in 2013. Late payments by member States have also become more frequent over time (Páleník, 2015). The critique of complexity and scarce transparency also affects the statistical way in which VAT-based resources, a source of financing, are calculated. The fact that own resources primarily derive from national contributions has often led to a clash between net receivers and net contributors. Therefore, in 2011 the European Commission expressed its intentions to make more operational use of own resources and to introduce new forms of financing. In this context the idea of a new European tax began to take shape. For instance, climate- or CO_2-tax (Siecker, 2015) has been claimed to be a valid incentive towards competitiveness leading to economic growth, although there have also been critical voices warning that the tax burden may weigh on consumers' shoulders (Luptacik, 2015) (Le Cacheux, 2007).

The exit of the United Kingdom as a consequence of the referendum of 23 June 2016 may be a further incentive, because a part of the EU budget would be lost. Depending on the outcome of the referendum, the question whether the EU funding should not be made otherwise could soon be raised once again. In addition to such a Damocles' sword hanging over the immediate future of the European project, there are unknowns, such as the final version of the Transatlantic Trade and Investment Partnership (TTIP) between the EU and USA. If it were achieved through massive cancellations of import duties, the EU budget might also lose parts of its income. Interestingly, in an Internet section called "Myths and facts" (European Commission, 2016e), European bodies still mention that the introduction of an EU tax would entail only a transformation of their financing system, but no tax increases.

There is no doubt that tax collection remains a means for public institutions to retrieve financial resources. The European case is interesting, as it implies at least two Government levels, namely the European and national, although several member countries are even more articulated in federalist terms. Accordingly, the tax burden is uneven across the European territory and no one-size-fits-all solution seems adequate to reflect the complexity of its economic and social needs. In any case, communitarian refinancing mainly relies on the following revenues (European Commission, 2016d):

1. **GNI-based own resources:** 0.7 percent of Gross National Income (GNI) representing the most important form of financing of the European budget. Although resources deriving from GNI originally aimed at covering expenses not otherwise financed by own resources, this way of funding has become the most significant revenue source of the European budget. In this specific regard, member nations are allowed to retain 25 percent of those amounts as collection costs. Unsurprisingly, GNI-based resources ensure a secure way of providing funds. Although the impact may not be as direct as VAT-based resources (which may have a causal influence on consumption propensity), they can be responsible for huge efforts in the case of slowly growing countries;
2. **"Traditional" own resources:** import duties of non-EU products in a high percentage, although they "have greatly lost in importance due to the fall of custom revenues in the course of trade liberalization and EU enlargement: whereas in 1980 they accounted for almost 50 percent of total revenues, their share has fallen steadily, declining to about 20 percent in the mid-1990s to about 15 percent since 2005" (Schratzenstaller, 2014). Any further liberalization of commercial and financial trade will reduce revenues from "traditional" own resources to the disadvantage of the communitarian budget. From this point of view, this source is going to become soon equal to "zero" (or something like this);
3. **VAT-based own resources:** 0.3 percent of VAT revenues. Economists may argue that VAT resources may be useful, because they do not directly affect people's pockets. In fact, these resources to the benefit of the EU budget are withdrawn from already applying VAT standard rates. Similar approaches do not take into consideration that VAT standard trades widely differ throughout the European territory. This leads to a greater use of different revenue sources where applying VAT standard rates are lower (bringing in less revenues);

4. **Other resources:** approximately 1 percent of the remaining funding sources derive from taxes and deductions from EU staff remunerations, bank interests or fines as well as contributions from non-EU countries to particular programs and interests on late payments.

The graphic description of funding sources in 2015 reaching to € 146.0 billion (European Commission, 2015) EU revenue is the following (Figure 1):

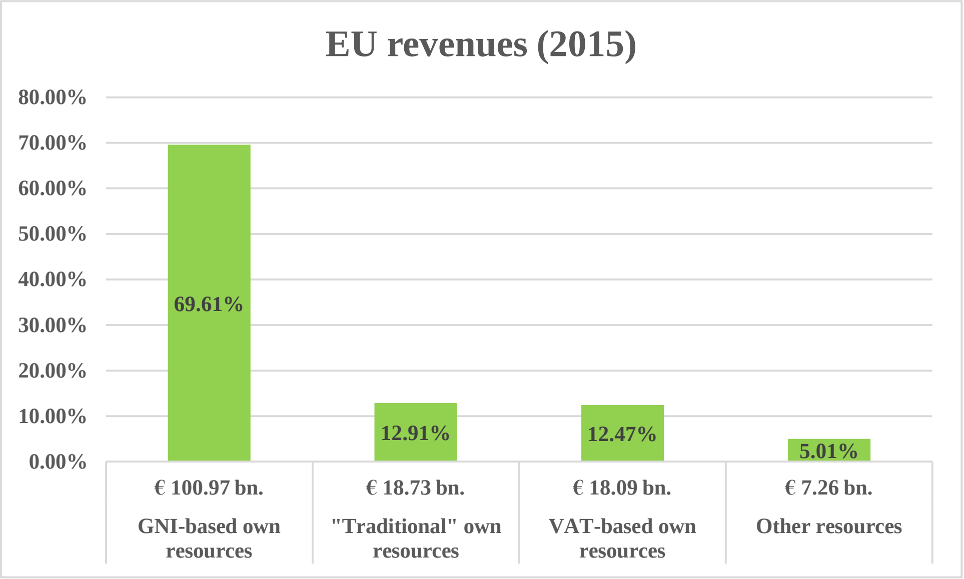

Figure 1. EU revenues (2015, bn. €)

Source: own representation on the basis of European Commission (2016c)

The European budget has been also criticized for allowing correction mechanisms to the advantage of certain member nations (European Commission, 2016g):

1. **The UK rebate (or correction):** on the one hand, the United Kingdom is reimbursed 66 percent of the balance between its contributions and what it has been refunded from the European budget. The impact of the UK rebate is covered by the remaining European member nations, although countries like Austria, Germany, the Netherlands, and Sweden are allowed to pay only 25 percent of the amount to cover the UK correction;
2. **Lump-sum payments:** on the other hand, the Netherlands and Sweden benefit from a reduction in terms of GNI contribution amounting respectively to € 605 million and € 150 million per year;
3. **Reduced VAT call rates:** finally, it has been agreed that 0.3 percent on the harmonized VAT base of each member country has to be withdrawn to the benefit of the European budget. Nevertheless, Austria, Germany, the Netherlands and Sweden benefit from reduced VAT rates each corresponding to 0.225, 0.15, 0.1 and 0.1 percent.

Now, if we express the above statements in the language of mathematics, the corresponding formula would have similar outlines:

$$EU\ budget = \frac{w}{100}GNI + \frac{x}{100}VAT + \frac{y}{100}traditional\ own\ resources + \frac{z}{100}other\ revenues$$

with:

$$1 \leq w \leq 99;$$
$$1 \leq x \leq 99;$$
$$1 \leq y \leq 99;$$
$$1 \leq z \leq 99.$$

"Traditional own resources" and "other resources" are nourished by custom duties and taxes on EU salaries or fines charged to firms in the case of law violations. If such contributions should be now entirely replaced by an EU tax – this is the first (though improbable) scenario – formula (1) would become less articulated:

$$EU\ budget = revenues\ from\ new\ EU\ tax \quad (2).$$

If the new EU tax were to represent only a portion of all annual income, the equation would become more complex:

$$EU\ budget = \quad (3).$$
$$= revenues\ from\ new\ EU\ tax + \left[\frac{a}{100}GNI + \frac{b}{100}VAT + \frac{c}{100}import\ duties + + \frac{d}{100}other\ revenues\right],^{1}$$

with:

$$0 \leq a \leq 99;$$
$$0 \leq b \leq 99;$$
$$0 \leq c \leq 99;$$
$$0 \leq d \leq 99;$$
$$a + b + c + d < 100.$$

Admittedly, one could easily be tempted to opt for equation (2). There is something that such an approach does not reveal: namely, the risk from excessive rigidity represented by less variegated revenue sources. Since European treaties already suffer from tightness, it remains questionable whether equation (2), namely the new EU tax as an "all-in-one" financing option, should be taken into consideration. In the case of equation (3), namely if the new EU tax would only complement today's funding sources, the level of complexity would increase, which is not the objective envisaged by European policymakers. With specific regard to VAT-based resources economists have advocated that "[t]he existing VAT own resource will be abolished; [t]he traditional own resources will be preserved. The GNI based resource will compensate the revenue losses due to the abolition of the VAT based resource. […] All EU member states will make the contribution of citizens to the EU budget visible on VAT receipts as the EU share in VAT. The purpose of this 'EU VAT rate' is exclusively to make the financing burden of the EU budget visible to citizens, its purpose is not to be the basis of real financial flows. This could happen at a later reform stage" (Fuest, 2015). We do not necessarily agree with the argumentation presented in the third point, because it may cause an even worse misperception of the EU burden on taxpayers' pockets. It is nonetheless true that VAT-based resources are unsuitable for extensive use in financing transactions. European VAT standard rates cannot be lower than 15 percent (European Council, 2006) and, at the same time, there are great discrepancies between member countries (Table 1). Correspondingly, continuing on this path may have a disproportionate impact on nations.

Current EU own resources well reflect their outdated character. In fact, traditional own resources based on duties belong to the past, where States used to hit international trade with charges levied on import of goods and services. At the same time, VAT-based resources seem simplistic being based (once again) on fiscal levies. GNI-based own resources seem more modern, although they affect the yearly economic performance of post-industrial countries (which cannot already expect huge growth rates). The European Union seems therefore to be in need of alternative solutions. In this part, we will present a new way of financing the European Union, designed to create a direct link to national taxpayers, who are, ultimately, EU voters.

3. The European Financing System: What's in Store for the Future?

There is broad consensus on the fact that the EU budget is in need of new financing methods. Undoubtedly, a good degree of sensitivity is required in the European case, where structural imbalances are already hampering the homogeneous impact of any policy measure. Among the aggravating factors there are other characteristics of communitarian agreements:

1. Monetary policies have now become the prerogative of the ECB, which has *de facto* cancelled all powers of influence by member nations;
2. Budgetary policies have been massively restricted by the Treaty on European Union *alias* Treaty of Maastricht (1992) and, even more so, by the European Fiscal Compact (2012), which prescribe 3 percent of the general budget deficit with respect to GDP and a structural budget deficit of no more than 0.5 percent of GDP for States with a debt-to-GDP level over 60 percent and of no more than 1 percent of GDP for States with a relative indebtedness below 60 percent;

[1] If a, b, c and/or d were equal to "zero", the corresponding source of funding would have been completely replaced.

Table 1. EU revenues (2015, bn. €)

	Standard VAT rate (as %)	GNI according to Atlas method (bn. $, 2015)	National contributions (bn. $, 2015)	Percentage of total national contributions	GNI-based resources (bn. €, 2015) - outturn	GNI-based resources (bn. €, 2017) - draft budget	Δ of GNI-based resources (bn. €)
Austria	20	405.72	2.53	2.13	2.12	2.12	-
Belgium	21	500.60	3.69	3.11	2.68	2.65	+0.03
Bulgaria	20	51.84	0.42	0.35	0.27	0.28	+0.01
Croatia	25	53.62	0.36	0.30	0.27	0.28	+0.01
Cyprus	19	21.83	0.21	0.18	0.11	0.11	-
Czech Republic	21	190.49	1.32	1.11	0.95	0.99	+0.04
Denmark	25	332.57	2.19	1.85	1.78	1.77	-0.01
Estonia	20	24.25	0.18	0.15	0.13	0.13	-
Finland	24	254.15	1.73	1.46	1.32	1.29	-0.03
France	20	2711.41	19.01	16.03	14.36	14.21	-0.15
Germany	19	3727.76	24.28	20.47	19.85	20.02	+0.17
Greece	24	219.63	1.21	1.02	1.16	1.12	-0.04
Hungary	27	127.88	0.95	0.80	0.70	0.71	+0.01
Ireland	23	216.61	1.56	1.32	1.06	1.14	+0.08
Italy	22	1993.90	14.23	12.00	10.45	10.49	+0.04
Latvia	21	29.49	0.21	0.18	0.16	0.17	+0.01
Lithuania	21	43.65	0.32	0.27	0.24	0.25	+0.01
Luxembourg	17	43.87	0.35	0.30	0.20	0.23	+0.03
Malta	18	8.89 (2013)	0.09	0.08	0.53	0.60	+0.07
Netherlands	21	828.80	5.76	4.86	4.36	4.42	+0.06
Poland	23	508.22	3.72	3.14	2.70	2.67	-0.03
Portugal	23	212.49	1.53	1.29	1.13	1.15	+0.02
Romania	20	188.39	1.32	1.11	1.02	1.08	+0.06
Slovakia	20	93.91	0.61	0.51	0.49	0.50	+0.01
Slovenia	22	46.67	0.34	0.29	0.24	0.24	-
Spain	21	1324.06	8.77	7.39	7.10	7.10	-
Sweden	25	566.49	3.51	2.96	2.86	3.06	+0.20
United Kingdom	20	2823.30	18.21	15.35	16.24	15.45	-0.79
= TOT. NATIONAL CONTRIB.	-	-	= 118.60	≈100.00	-	-	-
+ Traditional own resources	-	-	+ 18.73	-	-	-	-
= TOT. OWN RESOURCES	-	-	= 137.33	-	-	-	-
+ Other revenues	-	-	+ 8.69	-	-	-	-
= TOT. REVENUE	-	-	= 146.03	-	-	-	-

Source: own representation on the basis of European Commission (2016a), European Commission (2016f) and The World Bank (2016)

fiscal policies (mainly consisting of tax collection and redistribution) are now the only feasible way to cover national financing needs. It is undeniable that even this economic leverage has a precise limit of use, namely the acceptance degree of average taxpayers. Since discrepancies in terms of individual income tax rates are already significant as Table 2 shows, in several European countries there are only limited margins of fiscal action left.

Table 2. EU's individual income tax rates (as %)

Source: own representation on the basis of KPMG International (2016)

	2006	2016	Δ of individual income tax rate
Austria	50	55	+5
Belgium	50	50	-
Bulgaria	24	10 (2015)	-14
Croatia	45	40 (2015)	-5
Cyprus	30	35	+5
Czech Republic	32	22	-10
Denmark	59	56.4	-2.6
Estonia	21 (2008)	20	-1
Finland	51.4	54.25	+2.85
France	40	49 (2015)	+9
Germany	42	45	+3
Greece	40	45	+5
Hungary	36	15	-21
Ireland	42	48	+6
Italy	43	43	-
Latvia	25	23 (2015)	-2
Lithuania	33	15	-18
Luxembourg	39	44	+5
Malta	35	35 (2015)	-
Netherlands	52	52	-
Poland	40	32	-8
Portugal	42	48	+6
Romania	16	16	-
Slovakia	19	25	+6
Slovenia	50	50	-
Spain	45	45	-
Sweden	56.82	57.1	+0.28
United Kingdom	40	45	+5
AVERAGE	39.22	38.38	-0.84

Depending on the approach adopted, therefore, the popularity of Brussels Eurocrats could become more vulnerable. Since European VAT rates – the same is true of the taxation level of private and corporate income/assets – and Gross National Income diverge quite substantially the effect of any "new" EU tax should avoid disproportionate effects. Of course, one could easily argue that the EU takes advantage of increasing national VAT rates, which are a clear trend – at least, for those countries having adhered to the Euro Area (Beretta, 2013). At the same time, however, one might well claim that European institutions benefit from soaring growth rates, because the GNI and EU finances themselves are tightly interrelated. Before examining any potential EU tax in some detail, we should at least remind ourselves that it had to be guided by some principles:

1. In general, further taxation measures should be avoided. Communitarian institutions should instead take the opportunity to remove any fiscal connotation from their funding sources from fiscal connotations, which should never be associated with the term "tax" in order to increase the positive perception by EU citizens. In fact, "[a] reform of EU revenue cannot lose sight of the expenditure side of the budget. Irrespective of the visibility of its funding source, the basis for legitimacy of EU revenue lies in the possibility to convincingly demonstrate whether and to what extent EU expenditure has met the expectations and produced tangible and positive results for Europeans. It is this demonstration that can make citizens accept the corresponding taxation" (Cipriani, 2014). If we can, on the one hand, claim that the European Union is (still) made of 28 countries, affiliation to the European "Club" may, on the other hand, have become too costly. This is not only true of mere membership payments, but there are also other values to be taken into account (e.g. debt rules, limited economic sovereignty etc.). All these elements should also be taken into consideration while calculating the total costs of being a European Union member-state;

2. A different approach might be advisable. For example, returns on financial assets of European organisms or seigniorage revenues of the ECB might be more suitable. Even shares of GNI seem more appropriate to financing the EU budget, because they may have a lower impact on variables like investment, production or consumption.

The big issue with financial transaction taxes is that they may lead to additional earnings (unless, of course, investors prefer non-charged markets), but will not prevent creating and selling potentially pathological financial instruments. This seems to be even more the case of the European Union financial transaction tax (EU FTT), which should soon tax "safer" exchanges of shares and bonds at a rate of 0.1 percent, while tax "riskier" transactions on derivative contracts at a lower rate of 0.01 percent (European Commission, 2016b). It is therefore crucial to determine which way of funding the European budget may be less detrimental for local taxpayers. The main problem is for sure represented by the expenditure side of the European Union. Since these funds were no longer sufficient to cover the enlarging EU budget, in 1970 VAT-based resources were introduced to finance the Community budget. In 1979, this revenue source became the main way of financing, but was soon insufficient to cover expenditures as of the 1980s ("Thus Council Decision 88/376/EEC, Euratom of 24 June 198 (ORD 1989) introduced a new resource based on Member States' wealth (ESA 79 GNP, later replaced in 2002 by ESA 95 GNI)" (European Union, 2008)). By adding GNI-based resources the EU became sure that the expenditure side would be always covered by the revenue side. In other words, revenues from GNI would provide the remaining funds to finance outstanding expenditures. If we look more closely, however, we will find no correlation between expanding European Union and increasing needs of new resource typologies. In fact, even if member countries have grown in number over the years, one would have expected that the necessarily expanding EU budget would be covered by already existing financing sources. The first step towards a new European Union seems therefore to be a progressive reduction in the European budget itself, which should not be perceived as a burden weighing on the shoulders of local taxpayers. In fact, even if Brexit should not immediately occur, the issue regarding European membership (and its costs) will remain an object of discussion and may cause similar debates in other European regions too.

Skeptical readers may also claim that "more Europe" cannot be achieved through less budget. We plead for the opposite, namely that European taxpayers do not need "more Europe", but rather "better Europe". Since traditional own resources will soon drop to (nearly) "zero" because of the continuous liberalization of international commerce, the European Union will consequently lose part of its budget coverage. In addition, VAT-based own resources cannot be taken into consideration to compensate for diminished revenues, because they directly weigh on local consumers and present a technical limit of use, namely the acceptance by the involved economic subjects. Since VAT standard rates have grown over time, additional increases would be unsustainable. What would remain available would be GNI-based resources, possibly the less invasive source of financing. In fact, individuals are less affected by these sorts of financing measures, although the general economic wellbeing of each member country may well be. Since economists are aware that growth is not as dynamic as it used to be in the 1950s and 1960s, it is likely that rates will flatten. So GNI-based resources may well remain a way of financing the European budget, but given the fact that traditional and VAT-based own resources will respectively significantly diminish and are subject to a maximum threshold of use, European bodies cannot rely on a more pronounced use of the GNI-levy. In the light of this, which reform path should be taken? The leading light should certainly remain the same: the European project (provided it has to be considered a dogma) should be treated as "too big to fail" without suffering a chronic decline in reputation. Now, we have already pointed out that we are looking for a solution, which preserves the European autonomy and, at the same time, does not weigh on national taxpayers. Another aim should be the creation of a direct link between individuals and the European Union in order to establish the missing connection causing today's low interest in communitarian issues.

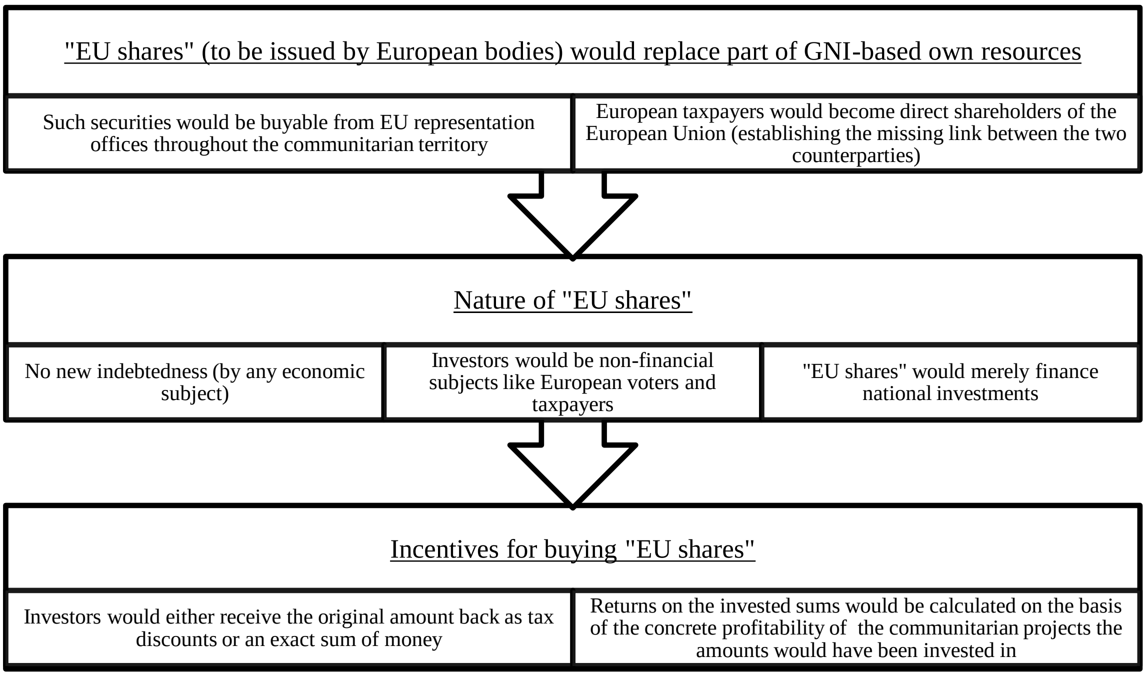

Figure 2. The “EU share” system after the reform

Source: own representation

A new solution could for instance be the following (Figure 2):

1. **Issue of “EU shares” substituting at least a part of the GNI-based own resources**: European bodies should start selling shares (or securities) to be bought by private individuals and non-financial companies, namely the real sector which has often criticized European bureaucrats of being scarcely interested in daily economy. These subjects would become able to buy such stocks through official channels like the 28 EU permanent representation offices as well as other (compatible) communitarian agencies. In order to avoid high concentration of ownership it may be imaginable to set a maximum threshold in terms of allowed (per capita) purchases. European taxpayers would therefore become shareholders of the European Union;
2. **Nature of the shares:** since European organisms are keen to avoid further indebtedness by economic subjects, these shares would not be a liability of the European Union at all and, more precisely, comparable to so called “Eurobonds” as known today. Otherwise formulated, a part of today’s GNI-based own resources would be financed through sellings of “EU shares”, which would contribute to national investments. Individual taxpayers would therefore have direct power of influence on European decision-making being not only active voters, but also financing subjects. The nature of the shares would imply:
    a. either that, at a given date, European taxpayers would receive the original amount back
    b. or that they would benefit from a corresponding tax discount at the national level.

    The latter option would be preferable, because on the one hand the European Union would not be in need of re-collecting those resources to refund them to European financers, but on the other hand individual investors would identify European bodies with a good opportunity to benefit from tax discounts;
3. **Incentives for buying “EU shares”:** skeptical readers may claim that, even if local taxpayers having invested in European shares received the original amount back in form of tax discounts or an exact sum of money, they would have no return in behaving similarly. This finding would not be true, although the European Union might provide an additional “sweetener”. In fact, investors would also receive a return on the given sums deriving from the profitability of those communitarian projects the original amounts have been invested in. Such returns on investments should be calculated by looking at the concrete profitability of the sums received. This would provide a direct incentive for European bodies and national policymakers to invest in a (more) useful way. At the same time, surveys may be introduced to

collect ideas on investments of people's desire. Such measures would minimize the perceived distance of European bodies from national taxpayers.

If the European Union were to combine such proposals with a sound reduction in the communitarian budget, European citizens would become more involved in communitarian life and, at the same time, benefit from safe investment alternatives. The non-financial target of these policies would also convince them that they have not been influenced by any other economic power. By adding this new EU own resource VAT- and GNI-based earnings would become less indispensable.

4. Conclusion

The European Union represents a great achievement in the history of Western nations. This result has its costs, but the revenue side should be constructed so as to prevail over the cost side (be it tangible or intangible in nature). It is true that European bodies have over-enlarged their own budget, but by carefully weighing the composition of EU own resources it may be possible to re-direct people's attention on the benefits from being European citizens. The idea of "EU shares" is an innovative one, which would finally create the missing link between taxpayers and European bodies. Fiscal incentives and returns on invested sums would be a great opportunity for European taxpayers, who would benefit from an alternative investment typology without being damaged by negative interest rates. If the European budget should shrink over time having become excessive compared to the original aims, it is no less true that EU own resources could be diversified without burdening local taxpayers. In the light of the proposals described above, VAT-based resources should dwindle in time, while GNI-based resources will decrease because of revenues from sales of "EU shares". There is no doubt that the European Union is in need of innovative solutions, which would confirm the validity of its purposes. But once again, as is often the case, the proper solution is definitely in our hands.

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