HIGH LEVEL GROUP ON OWN RESOURCES

Executive summary and Recommendations

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Executive summary

Genesis and mission of the High Level Group on Own Resources (HLGOR) and First Assessment Report

The High Level Group on Own Resources was established to examine how the revenue side of the EU budget can be made more simple, transparent, fair and democratically accountable.

The Group's First Assessment Report presented at the end of 2014 scrutinises the present system of own resources closely, with regard to its positive aspects and the substantial improvement needed, in terms of spending and revenue.

Criteria were developed to benchmark progress and questions were formulated to guide further examination. These went beyond the normal technical analysis of different sources of income, addressing the procedural and legal implications, and political and institutional interdependencies.

In the course of the deliberations of the HLGOR that took place in 2015 and 2016, the urgency and relevance of this examination were emphasised by multiple crises which served as wake-up calls that a much closer cooperation was needed at the EU level: the refugee crisis put in stark evidence the gaps in the Schengen zone of free movement; the multiple terrorist attacks in 2015 and 2016, most notably in France, revealed that more cooperative action had become imperative to ensure both the internal and external security of Member States; and not least, the existential risks associated with global climate change remind us that the EU is a Community of shared destiny for the long term and that, when this Community speaks with one voice and commits to common goals, it can influence global solutions. The EU has encountered great difficulty in addressing these challenges and redirecting EU capacity of action over the last years, which serves to underline how crucial financial resources have become in solving pressing issues internally and externally.

The introduction and Part I of the report explain why a functional EU budget is essential. They make the case for a substantial reform, where changes on the revenue side are an integral part of a larger reconfiguration of the Multiannual Financial Framework (MFF). The report also mentions which aspects of the present system work well and should be maintained.

The specific features of the EU budget, the MFF and the own resources system compared to national systems.

The observation that the EU budget is a 'sui generis' construction is not a ploy to hide its complexities. In the course of the debates of the HLGOR, it quickly became evident that much of the fierce criticism, mistrust and sometimes even misguided decisions stem from the wrong assumption that the EU budget is 'just' a 29th budget 'for Brussels'. This perception ignores the fact that the choices made concerning the EU budget are largely for the medium term.

The EU budget is primarily an investment budget with some redistributive functions between the Member States. It serves mainly to support common EU policies and objectives, underpinning the advancement of the acquis communautaire on a multiannual basis, and provides seed money for medium- to long-term investments. The flexibility and influence for short-term crisis intervention remains a weakness that must clearly be addressed. The budget is too small for real anti-cyclical economic stabilisation and substantive redistribution, which are a mainstay of national budgets, or for what orthodox wisdom would require of a 'federal-level' budget.

Finally, the budget must always be adopted as a balanced budget, which conditions the revenue system. Because of this requirement, the revenue is called so as to cover the expenditure voted by the European Parliament and the Council each year (ex-ante at the level of payment appropriations). This means that the EU budget does not run an annual deficit, is not financed by borrowing money on the financial markets and thus does not build up public debt. In order to level out evolving needs on the spending side and imponderables on the revenue side, the uniform call rate for the residual, balancing contribution based on gross national income (GNI) is periodically recalibrated to cover the exact needs.

This last point is crucial to understanding what a reform of own resources along the recommendations presented by the HLGOR would lead to. Windfall income such as competition fines or higher than expected customs duties does not lead to additional spending possibilities, but to lower GNI-based contributions. The level of annually authorised appropriations, the MFF ceilings and the own resources ceiling are binding safeguards of budgetary discipline. The present report focusses on what can be reformed under the current institutional setup, taking into account that fiscal competences remain at the national level, and within the overall constraint of budget neutrality so that the reform of own resources envisaged do not create additional tax burden on EU citizens.

Concepts and definitions, European added value, net balances.

The report clarifies conceptual issues and key notions, primarily to explain the differences between a 'European tax', own resources (some more 'genuine' than others) and other revenue sources. The treaties do not give the EU the competence to levy taxes but provide the Union with 'own resources' to achieve its objectives (Article 311 TFEU) while respecting the fiscal prerogatives of the Member States.

EU own resources, unfortunately, are interpreted in national budgets in a great variety of ways. This makes comparisons between Member States almost impossible and results in a conceptual bias where some own resources are in fact considered a national transfer or 'cost' item, and not a resource 'owned' by the EU. A first step towards more transparency would therefore be to acknowledge own resources for what they are, and provide a clear and standard presentation of contributions to the EU in national budgets.

The report also analyses how the notion of European added value, which can be defined as the value resulting from an EU intervention which is additional to the value that would have been otherwise created by Member State action alone, can guide future budgetary decisions on the expenditure side. Taking into account the most recent trends and developments in EU policies, the analysis leads us to deduce that the EU budget is not as outdated as one might think, having undergone considerable changes, but that it is still insufficiently focused on the tasks that would generate the most European added value.

What is striking and unsustainable is that, when it comes to the basic data that each Member States uses to define its position in budgetary negotiations — its budgetary balance — European added value is completely ignored. Budgetary balances are calculated by simply offsetting what a Member State is allocated on the expenditure side with its national contributions. Under this method, every euro spent in one country is considered a 'cost' for everybody else. It therefore entirely ignores any European added value stemming from EU policies that benefit some or all Member States. Calculating one's own 'benefit' from the EU budget is not what is being condemned here; it is a natural or at least inevitable endeavour. What is misleading and causes damages to the EU and the Member States themselves is that a narrow and lopsided indicator becomes the only measurement of a cost-benefit relation.

The report argues that a broader measurement should be sought of the collective benefit of EU policies, economic synergies, cross-border effects and positive external outcomes. This would not only be more accurate, but would hopefully overcome the juste retour dilemma which has transformed the EU budget, and by extension the EU, into a zero-sum game instead of the win-win arrangement it is expected to be. Because this method was introduced to calculate the UK rebate, the withdrawal of the UK from the EU and the discontinuation of the 'British rebate' –as well as of 'the rebates on the rebate'- provide a unique window of opportunity to review how we measure the real costs and benefits of the EU.

Part II discusses building blocks for a comprehensive reform and examines potential options

The Group has worked consistently with a set of criteria to assess and compare different types of revenue sources. Most of them are non-controversial and universally applied to public tax revenue, such as efficiency, sufficiency and stability of revenue sources. Others such as fairness are more complex to understand at EU level because of another essential difference to national budgets: under the current system, Member States are the only tax payers to the EU budget, not the 510 million EU citizens who only contribute indirectly. This explains why Member States generally strongly support the GNI-based own resource, which is seen as the benchmark of fair burden-sharing. As it is currently implemented, however, together with the corrections and reductions granted to some Member States, it does result in a 'regressive' system. This fact, seen in relation to democratic accountability, is problematic. Looking at the EU budget from the point of view of the tax-paying citizen, or the consumer in the single market, would result in a different notion of 'fairness' leading to new forms of fiscal equivalence.

Some criteria are more specific to the EU, such as European added value and subsidiarity, which require the most mobile tax bases to be targeted by the highest level of European governance, as the national level is becoming increasingly less efficient at tapping them for fear of tax competition. This imperative of fiscal logic is, however, less easy to apply to the own resources system.

Finally, the report strongly argues in favour of new own resources which would help enforce some EU policies and support EU policy objectives, in particular economic, social and environmental sustainability. Some taxes or levies targeted to fight climate change or promote energy efficiency, for example, have long been recognised at the national level as ways to promote political preferences through taxation. A similar approach could be adopted if a coordinated tax were to be introduced in Member States, and some of its proceeds attributed to the EU budget. It would then participate in an EU policy. We have become used to the EU-level expressing political choices mostly through spending and subsidies. By better linking own resources (or other revenue) with common policies, this bias could be rectified.

The report confirms previous findings that there is no single ideal option, only several suitable ones.

Alongside the elements of the current system which work well and should be kept, and the ones which should be abandoned, the Group examined in details several possible new revenue sources which have also been singled out by most analysts and academics. On this basis, a comprehensive and viable reform of the system of own resources could be based on a combination of new resources stemming from production, consumption and environmental policies. At this stage it appears more constructive to present a wide range of revenue sources having the required qualities rather than create unnecessary resistance to any specific option.

- Possible new own resources related to the Single Market and fiscal coordination concern a reformed VAT-own resource (replacing the existing one), an EU corporate income tax, a financial transaction tax and other financial activities' tax. These candidates would have the advantage of contributing to the better functioning of the Single Market and, particularly in the case of VAT and corporate income tax, promote fairer taxation and help combat tax fraud or tax avoidance, in addition to financing the EU budget.
- Candidates related to the Energy Union, environment, climate or transport policies include a CO2 levy, proceeds from the European emission trade system, an electricity tax, a motor fuel levy (or excise duties on fossil fuels in general), and indirect taxation of imported goods produced in third countries with high emissions. These candidates would also contribute to the better functioning of the single market if they limit the proliferation of such taxes in an uncoordinated manner, and would create a link between the financing of the EU budget and EU policies.

Finally, own resources are not the only possible source of income for the EU. The category of other revenue has been neglected in past reflections but could become a complementary element in the financing basket. Other revenues stem directly from EU secondary legislation and could concern border control, the digital single market, environmental protection or energy efficiency (such as the excess emission premiums for cars which are already planned). Some of the candidates for new own resources mentioned above could also be candidates for 'other revenue', depending on the legal design envisaged and the possible political compromise.

Part III looks at practical ways forward, such as differentiation, before presenting the possible components of a global European financial reform, applicable to both the expenditure and the revenue side.

Since the first ideas of differentiation were developed over 20 years ago, it has become a generally accepted solution that forward-looking policies which were not mature enough to be endorsed at the EU level, could be adopted by a coalition of the willing. Differentiation usually refers to a policy which is pursued by a core group of Member States which are both able and willing to go further, with the underlying assumption that other Member States will follow later.

This naturally has consequences on the revenue side, where there is already some measure of differentiation for countries which make use of an opt-out, or countries which benefit from a rebate. The HLGOR has therefore examined this issue to define possible future options.

It recognises that a unified, universal and coherent way of financing the budget should remain the norm and that fragmentation of the EU budget entails many risks, particularly regarding democratic accountability and effectiveness. Any deviations should therefore remain an exception, be clearly justified and benchmarked against the usual financing of EU policies as laid down in the Treaty, which assumes that all Member States are participating, that the unity and universality of the budget are preserved and that decisions are taken according to the Community method and respect the specific features of the MFF and the Own Resources Decision.

The report then examines the circumstances under which differentiation could be justified. The treaties offer opportunities for frontrunners to make progress through the provisions for enhanced cooperation. A case in point is the Financial Transaction Tax, which was initially rejected at EU-28 level and has been brought forward by a group of 10 Member States. Further advances for euro area members could become another and the report points to particular sources of revenue which would be relevant in this context. Some differentiation might therefore be an element in the overall future compromise package.

The report concludes by proposing the possible components of a global European financial package, applicable to both the expenditure and the revenue side:

» re-structure the MFF with more common public good spending focussing on achieving higher European added value and corresponding to the nature of the challenges;

» introduce new own resources alongside traditional own resources and the GNI-based own resource, which would fulfil the classical sufficiency and stability criteria, vertical and horizontal aspects of 'fairness' requirements and also tackle policy objectives;

» explore other revenue sources emanating from EU policies and programmes, which would be entered as simple revenue, rather than own resources, to the EU budget;

» apply minimal procedural reforms;

» include elements of differentiation, such as enhanced cooperation if strictly justified.

The upcoming negotiations on the next MFF will take place in a unique context: unprecedented scepticism about the EU (and for the first time, the prospect of one of its Member States leaving); a widening gap between the main fields of EU action and the expectations of EU citizens; and calls for action in new areas which were not EU priorities until now.

While most of these challenges at first appear to concern the expenditure side of the EU budget, or areas which could be addressed by regulation rather than spending programmes, the long neglecting of how the EU is financed also explains why it is so difficult today to address the challenges we are faced with. Some argue that the strong support for the status quo on the EU financing structure — in particular from Member States — is merely an inevitable consequence of inadequate spending policies. Others argue the opposite — that policy inadequacies can be explained by an entrenched funding system. It is time to tackle this dilemma.

The reform of budgetary revenue is neither an end in itself nor a panacea to cure all budgetary ills. It should be seen as a building block in the ongoing effort to restore trust and legitimacy to EU action by making the EU's own resources system simpler, more transparent and equitable and democratically accountable.

Recommendations

In compliance with its mandate, the HLGOR presents below its recommendations to the Presidents of the European Parliament, the Council of the European Union and the European Commission. The recommendations build on its First Assessment Report, on the external study it commissioned, as well as on discussions with national parliaments held at the Conference on the future financing of the European Union on 7-8 September 2016.

#01 A reform of the EU budget is necessary on the revenue side. It should be undertaken together with a reform of the expenditure side to address today's new priorities.

The effectiveness of the EU general budget depends on the capacity — and the public perception thereof — to address EU priorities and to help solve the challenges our citizens face in their lives, be they economic, security-related and geopolitical, social or cultural.

This effort is not helped by the present system of financing, which has gradually become a system of national contributions where the EU budget is perceived as a zero-sum game between 'net contributors' and 'net recipients'. Moreover, such a system could create an unsustainable ratio between payments and commitments that needs to be closely monitored.

A reformed system of own resources should contribute to achieving our policy objectives, while also fulfilling its task of funding the EU budget appropriately, and easing the adoption of the budget. EU citizens deserve a budget that meets these challenges head-on whenever action at EU level is called for. The preparations for the next Multiannual Financial Framework (MFF) are about to begin. They will take place in a unique context which could help in overcoming the traditional obstacles to reform encountered on the revenue side. The next MFF will afford the opportunity to re-evaluate how the EU budget can support Member States and European citizens in a more efficient and effective way, and it is crucial to maximise on this opportunity. This should involve reflecting on the revenue side, and the size and composition of the expenditure, in order to match the objectives of and demands on the EU budget.

#02 The following principles should guide the reform:

- European added value: In times of scarce public resources but growing financial needs, the EU budget needs to focus on areas bringing the highest 'European added value', or on European public goods for which action at EU level is not only relevant, but indispensable, or where national financing possibilities are insufficient for achieving our European goals. The Commission should demonstrate with concrete examples that a targeted, selective use of a central budget can lead to economies of scale, efficiency gains and better address external issues.
- Subsidiarity: Changes to the composition of EU own resources should respect the powers of the national authorities to decide on them; on the expenditure side, any reform should include a subsidiarity test to determine the level at which spending should be best undertaken: sub-national, national or European.
- Budget neutrality: The size of the budget is firstly determined by the own resources ceiling and secondly by the MFF, i.e. on the expenditure side. The structure of EU financing does not, as such, have an impact on the volume of the EU budget. The introduction of new own resources or other types of revenue would therefore — all other things being equal — result in reductions in GNI-based contributions, and could thereby create some margin of manoeuvre for national budgets or national fiscal policy.
- Overall fiscal burden: New own resources do not aim to increase the fiscal burden for the EU tax payer. On the contrary, a reduction in national contributions, combined with EU spending that is better geared towards policies with higher added value such as security of external borders or defence, are also aimed at better European governance and can create savings for Member State budgets.
- Synergies: Given constraints on the EU budget and the pressure on public expenditure in general, most European objectives should be sought through complementarity between the European and national levels. Greater attention should be given to synergies between the EU budget and national funding for areas with a high European added value or where national financing possibilities are insufficient for achieving a European public good. This approach is essential for restoring legitimacy to EU and public spending in general.
- Unity of the budget: The unity of the EU budget should be explained and preserved, and 'satellite' budgets should be limited to strictly justified cases and subject to proper parliamentary scrutiny.
- The EU budget and its financing should be more transparent and readable for citizens, so that the benefits of the EU, and not only its costs, are made visible. This would improve the overall accountability of the EU budget.
- Own resources should not only be used to finance the EU budget in a sufficient, stable and fair manner. They should also be designed to support EU policies in key areas of EU competence: strengthening the Single Market, environmental protection and climate action, energy union, and reducing the fiscal heterogeneity in the Single Market.
- Not only would a reform anchored in these guiding principles be completely justified, but it would also have the advantage of: providing a visible link to EU policies and priorities; improving overall budget coherence at EU and national levels; and promoting a sustainable financing system.

#03 Some elements of the current system work well, are simple, equitable, efficient, and should be kept:

» The principle of equilibrium of the EU budget, which is important in ensuring budgetary discipline, together with the own resources ceiling and the MFF.

» Traditional own resources (customs duties), which are a benchmark of true EU revenue and whose collection process is satisfactory.

» A GNI-based own resource, if used as a balancing and truly residual resource.

#04 The most suitable options for new own resources.

The HLGOR conducted a thorough examination of possible options in the context of proposing a better mix of revenues with all the required qualities of a well-functioning, stable, transparent and fair system of own resources. The Group found that a comprehensive and viable reform of the system of own resources could be based on a combination of new resources stemming from production, consumption and environmental policies. The best options for establishing a link with EU objectives and added value would concern:

a. The Single Market and fiscal coordination: Reformed VAT-own resource (replacing the existing one), corporate income tax-based own resource, financial transaction tax or other financial activities' tax would have the advantage of improving the functioning of the Single Market. Moreover, particularly in the case of reformed VAT and EU corporate income tax, they would promote fairer taxation and contribute to the fight against tax fraud or tax avoidance — VAT being the only tax already covered by EU law.

b. The Energy Union/environment/climate/transport policies: the CO2 levy, inclusion of the European emission trade system proceeds, an electricity tax, a motor fuel levy (taxes on fossil fuels/excise duties), or indirect taxation of imported goods produced in third countries with high emissions.

New own resources could be introduced with the new MFF. They could be phased in gradually or with certain pre-conditions, such as sufficient harmonisation of the tax base or an equitable transition to the new system.

The HLGOR considers that the objective of a future reform should be to finance the majority of EU expenditure via genuine own resources[1].

#05 Examine other possible revenues linked to EU policies.

Revenue other than own resources can also finance the budget and should be explored. For example, auctioning proceeds or other revenue stemming from EU policies such as border control, the digital single market, the protection of the environment or energy efficiency (excess emission premiums for cars), or resulting from EU competences, should in principle accrue to the EU budget, under the control of the European Parliament and the Council. Because these revenues have a direct link with EU policies, they are visible and simple. Their use would have to be decided on a case-by-case basis. They would be used either to finance the general budget and simply decrease the national contributions or create a reserve on the expenditure side, or be earmarked for a specific purpose.

1. One member of the group thinks that, under the current institutional framework of the EU, abolishing the VAT based own resource and simplifying the system of national rebates would considerably improve the financing system in the light of the relevant criteria while the case for adding new own resources is much weaker.

#06 Aim at a more comprehensive and accurate notion of 'costs', 'benefits' and 'net balances'.

The current perception of the EU budget as a zero-sum game does not reflect the European added value dimension of EU policies, and tends to favour pre-allocated expenditure by Member States to the detriment of current or future EU policies with clear European added value such as internal and external security, combating climate change, research and defence. Naturally, it does not take into account benefits, which are not measurable either, such as participation in the largest single market or belonging to one of the heavyweights in world trade and climate negotiations.

The Group recommends addressing this problem in two ways. The first is to introduce alternative revenue sources, which are not perceived as national contributions but rather as resources directly linked to the European dimension.

The second is to look critically at the current methodology of net balances, which was introduced to calculate the UK correction, and develop additional indicators or tools beyond the current calculation of net balances that allow for a more comprehensive appraisal of the costs and benefits of EU budgetary interventions. Such methodology and/or additional indicators need to better reflect the collective benefits of EU expenditure, as well as the costs and benefits per Member State. These costs and benefits include the financial flows triggered by EU budgetary interventions in Member States, such as the investments linked to EU financial instruments, or by other forms of EU financial assistance. This will show that one Member State's gain is not inevitably at the others' cost. A study should be commissioned to this end.

#07 Corrections and rebates.

Withdrawal of the UK from the EU entails the discontinuation of the UK correction mechanism and the related 'rebates on rebate'. This in turn makes much of the rationale for the present statistical VAT-based own resource superfluous.

More generally, any correction mechanism on the revenue side should be abolished. The balance between own resources has to be so that we can avoid any correction mechanism. In case of any excessive burden caused by one or another own resource on a Member State, it could be alleviated by means of a specific compensation limited in duration and amount, and preferably calculated in terms of lump sums. Such an approach would make the own resources system simpler and fairer.

#08 Review the vertical coherence of the EU and national budgets within the European Semester.

It is recommended that the link between the EU budget and the overall fiscal policy governance framework be strengthened in order to create synergies and minimise the fiscal burden where possible.

On the expenditure side, the coherence of EU and national budget spending would be a key point of any reform, taking into account several principles — the need to have expenditure at the right level (EU or national), the identification of common objectives for both EU and national budgets and the quality of public finances (growth-friendly expenditure).

On the revenue side, better information channels should be opened in relation to national budget procedures, the European budget procedure and the European Semester so that national contributions to the EU budget are clearly understood and anticipated, and shared objectives better aligned. A comparable budgetary and accounting presentation of own resources in national budgets would be a first step in this direction, and would facilitate parliamentary scrutiny.

#09 Allow for a certain degree of differentiation (géométrie variable).

The fundamental budgetary principles of unity and universality of revenue should remain the 'point of departure' of any reform effort and not be jeopardised. Only when some Member States wish to go further in some areas of EU integration, differentiation on the revenue side could be a workable solution, notably:

» for the further development of the euro area. Earmarking such revenue sources for specific items of expenditure would also be easier to justify in this context. Some candidates examined by the Group could be suitable for the euro area, such as the financial transaction tax, possible contributions from the banking sector or the income from seigniorage stemming from the European Central Bank.

» for policies under enhanced cooperation where there is a coalition of frontrunners (new policies such as defence).

The HLGOR considers that these recommendations are compatible with the current European treaties and could be implemented under the next MFF. Where the report addresses some forward-looking ideas which could only be implemented through a Treaty reform, this will be clearly stated. In any case, it should be borne in mind that changing the own resources decision requires the unanimous agreement of Member States, after consultation of the European Parliament, and ratification according to national procedures.

For more information:

ec.europa.eu/budget/mff/hlgor