

Cercle 3
Working document 01

NOTE

from :	Secretariat
to :	"Discussion circle" on own resources
Subject :	Note describing the system of own resources

INTRODUCTION

The own resources of the Union are defined as revenue of a fiscal nature allocated to the Union once and for all to finance its budget, due to it as of right without any further decision having to be made by national authorities.

The system of own resources as it exists today has built up gradually.

Unlike the ECSC Treaty, the Treaties of Rome did not provide for the immediate establishment of own resources to fund the Communities which they set up: funding for the two Communities (EEC and EAEC) was initially provided by financial contributions from Member States. However, the Treaties did envisage the subsequent establishment of a system of own resources, to include in particular revenue from the Common Customs Tariff once that tariff had finally been put in place. It was on that basis that own resources, replacing national contributions, were introduced by the Decision of 21 April 1970¹. That Decision made a distinction between:

¹ OJ L 94, 28.10.1970, p. 19.

- *own resources per se*, stemming directly from the existence of a unified customs area and where national allocation is legally – and in practice – impossible; these resources, known in Community practice as "traditional own resources", consist of:
 - Common Customs Tariff duties progressively levied by the Communities between 1971 and 1975;
 - agricultural levies and levies on sugar and isoglucose wholly imposed by the Community since 1971;

and

- *the VAT own resource, intended to balance the budget*. This resource is based on the VAT collected by Member States, to which a uniform rate is applied, valid for all Member States, initially set at 1% of the VAT assessment base determined in accordance with Community rules. This rate has subsequently been revised several times. It is 0,75% for 2002 and 2003 and will be 0,50% from 2004. The effective implementation of VAT receipts has been carried out gradually, in line with progress in harmonising the VAT assessment base (Sixth Directive, 1977, and Ninth Directive, 1979).

Since 1988, the VAT assessment base has been determined in all Member States according to the "revenue" method which consists of:

- taking the net revenue collected as VAT by each Member State during the year, adding certain corrective measures;
- dividing that revenue by the VAT rate charged during the year in question (given that despite efforts to align them, VAT rates remain national). Since, in the majority of Member States, several rates of VAT apply depending on what product or service is being taxed, the total amount of revenue collected is divided by a "weighted average rate" which is determined by a Regulation using an estimate of the average rate applied to the various categories of taxable items. This method therefore derives from a statistical calculation.

This produces what is known as the intermediate base;

- the intermediate base is the subject of positive or negative compensation measures carried out on the basis of tax data provided by the Member States. The final base before capping of the VAT resource is then achieved for the year in question for each Member State.

Since 1988 a capping rate has been applied to the VAT assessment base. Originally applied only to the less prosperous Member States, capping now applies to all Member States: it consists of only taking the VAT assessment base for each Member State into account up to a level of 50% of its GNP.

The minimum applicable rate determined in the framework of the own resources Decision ² is then applied to the assessment base for all Member States. The amount obtained then has to be corrected so as to take account of the financing of the United Kingdom correction (see below).

A "fourth resource" was subsequently incorporated into the system by the Decision of 24 June 1988. This is based on the GNP of Member States and derives from the application to an assessment base representing the sum of the gross national products at market prices of a rate determined in the framework of the budgetary procedure, taking account of what is obtained from all the other categories of own resources.

Finally, since the Decision of 7 May 1985 implementing a decision of the Fontainebleau European Council of June 1984, this system includes a compensation mechanism establishing a correction at source for the United Kingdom, intended to correct the structural imbalance of the financial relationship between the Community and the United Kingdom, which resulted from the particular situation of that country at the time of its accession; this was characterised on the one hand by a relatively modest agricultural sector and by consumption of agro-alimentary products largely dependent on imports from third countries, resulting in low Community expenditure on agriculture in the United Kingdom; and on the other hand on a significant contribution to the financing of the Community budget, resulting in particular from the relatively high VAT assessment base in relation to the GNP of the country. The United Kingdom is therefore given a correction at source: two thirds revenue (66%) of the difference between the United Kingdom's share of VAT revenue and its share of allocated Community expenditure, applied to total allocated expenditure, is refunded to the United Kingdom by way of a reduction in the UK VAT base.

² In reality, use is made of a "uniform rate", the difference between the maximum rate and the uniform rate being the percentage of the VAT assessment base needed to finance the United Kingdom correction.

This rebate for the United Kingdom entails an additional burden for the other fourteen Member States added to the VAT payments from each of them, so that the rebate does not result in a reduction of the total own resources available: funding of the rebate is currently divided, taking into account a 75% abatement for Germany, the Netherlands, Austria and Sweden, between the Member States in proportion to their GNP.

Whereas in 1971 agricultural levies and customs duties represented respectively around 57% and 43% of own resources, currently own resources can be broken down as follows: GNP: about 44%, VAT: about 40%, customs duties: about 15% and, finally, agricultural levies: about 1%.

THE ESSENTIAL FEATURES OF THE PRESENT SYSTEM OF OWN RESOURCES

Although there has been no major shake-up of the own resources system since 1988, regular adjustments have been made to it. It is currently based on Council Decision 2000/597/EC of 29 September 2000 on the system of the European Communities' own resources ³ and on two implementing regulations. ⁴

The financial aspect: a guaranteed level of resources for the Community

The first own resources system introduced was based on resource allocation mechanisms which bore no relation to needs. For the Community this has led to difficulties since the beginning of the '80s in covering its increasing needs.

The system set up in 1988 aims to adapt the own resources ceiling to anticipated developments in expenditure. Under this overall ceiling, the introduction of GNP as the fourth resource has made it possible to achieve the required balance between revenue and expenditure.

³ OJ L 253, 7.10.2000, p. 42.

⁴ Regulation (EC, Euratom) No 1150/2000, which lays down the conditions for implementing the Decision, and Regulation (EEC, Euratom) No 1553/89 on the definitive uniform arrangements for the collection of own resources accruing from value added tax.

(1) The link between resources and expenditure

An overall ceiling for own resources is set and expressed as a percentage of Community GNP (1,27% ⁵ for the period 2000-2006). The overall nature of the ceiling means that it applies to own resources considered as a whole and to all Member States taken collectively. It is established in conjunction with the expenditure ceiling set in the financial perspective (in terms of appropriations for payments) over a medium-term period (currently 2000-2006).

Furthermore, there are other provisions which ensure compatibility between developments in expenditure and the own resources ceiling:

- the expenditure ceilings in terms of appropriations for commitments in the financial perspective are set in such a way as to maintain an orderly progression in relation to all the necessary appropriations for payments. Under the own resources Decision (Article 3(2)), the total amount of appropriations for commitments entered in the budget may not in any event exceed a certain percentage of Community GNP, set at 1,335%, taking into account the new method of calculating GNP;
- pursuant to the provisions introduced by the Maastricht Treaty (Article 270 TEC), the Commission must ensure in advance that the proposals it makes and the implementing measures it adopts are capable of being financed within the limits of own resources. ⁶ The maximum own resources ceiling continues to apply, unless the basic Decision is amended, even if the financial perspective is not renewed when it expires. This ensures continuity of the financing system, while imposing a limit on the increase in expenditure.

⁵ 1,24% under the new accounting system.

⁶ This principle is incorporated in draft Article 39(5) of the Constitutional Treaty (CONV 602/03).

(2) Finalisation of financing from the GNP resource

In addition to the sum of traditional own resources and the VAT resource, the returns on which ensue from the rates applicable and the actual evolution of the assessment bases, the financing of expenditure is ensured, up to the general ceiling for own resources, by revenue based on GNP. This resource is therefore intended to ensure budgetary balance, hence the frequent reference to it in budget documents as a "complementary resource".

The legal dimension: the "own" aspect of the resources

(1) The legal reasoning: a definitive transfer of tax resources by the Member States under a particular procedure

The system of own resources can be summarised as a definitive transfer of tax resources to the Community. By virtue of Article 36(2) of the Financial Regulation ⁷, once the budget for each financial year has been finally adopted, each Member State is required to make over to the Community the payments due under the budget. It is because of the Member States' undertaking to supply the necessary own resources that such an especially cumbersome and formal procedure was established for the adoption of basic decisions in this area provided for in Article 269 TEC (unanimity in the Council plus national ratifications).

(2) The consequence: making resources available automatically

In the absence of a Community tax administration, traditional own resources are collected by Member States' administrations. Regulation (EC, Euratom) No 1150/2000 (Article 2) provides that the Community's entitlement to the own resources is established as soon as the debtor has been notified of the amount due by the competent authority of the Member State. The entitlements are

⁷ Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 248, 16.9.2002, p. 1).

calculated and then entered in an "own resources" account opened for this purpose with the national treasury by the Commission, in line with the flow of actual contributions.

However, VAT and GNP resources not subject to separate collection from debtors are made available on the first working day of each month, at the rate of one twelfth of their estimated amount set out in the Community budget.

This availability is guaranteed by Regulation (EC, Euratom) No 1150/2000 (Article 11), which provides that any delay in entry gives rise to the payment of interest on arrears by the Member State concerned.

The "own" aspect of the resources and, consequently, financial autonomy are sometimes obscured by the fact that the payments under own resources often appear in national budgets and therefore seem to be subject to a vote in national parliaments. The intervention of national parliaments as part of the budget procedure of Member States, however, perpetuates a misunderstanding regarding the automatic nature of the transfer of resources.

The economic dimension

(1) The financing system prior to the 1988 reform, the main component of which was the VAT resource, was felt to be doubly unfair:

- the VAT resource is structurally regressive insofar as in the least prosperous Member States consumption accounts for a higher proportion of GNP than in the wealthiest Member States, which is reflected by a relatively higher VAT base in GNP. Conversely, countries which are net exporters and have a high savings rate are at an advantage;
- the predominance of the VAT resource was, together with the distribution of agricultural expenditure, at the root of the budgetary imbalances which placed the United Kingdom at a disadvantage. The corrective mechanism established in 1984 following the Fontainebleau agreements was reflected by a reduction in the total own resources available, bearing in mind that a ceiling of 1% of a common assessment base was placed on the call-up rate.

(2) *the system which emerged from the 1988 Decision, confirmed by the 1994 and 2000 Decisions, shows significant development on two points:*

- the base to be used for the application of the uniform VAT rate may not exceed a certain percentage of a Member State's GNP, set at 50% as of 1995. Moreover, the maximum call-up rate for that resource has been, and will continue to be, progressively reduced, bringing it down to 0,5% in 2004;
- the creation of the fourth resource (supplementary resource based on GNP) ties budget financing to a tax base that more accurately reflects the real wealth of Member States. While a series of decisions adopted a system of correcting budget imbalances extending, in practice, the approach adopted in Fontainebleau, the correction for the United Kingdom no longer results in a reduction of the total own resources available: financing of the correction is currently spread among Member States in proportion to their GNP, bearing in mind the 75% abatement for Germany, the Netherlands, Austria and Sweden.

The gradual replacement of the VAT resource by the GNP resource has had the mechanical effect of greater equity in Member States' gross contributions, in other words greater proportionality between the wealth produced by a Member State and its gross contribution. Such proportionality is now respected for all Member States, with the exception of the United Kingdom on account of the correction carried out. That trend will continue in years to come as the VAT resource share is set to fall still further in accordance with the "own resources" Decision of 29 September 2000 ⁸.

Proportionality will not, however, be perfect, for three reasons:

- the continuation of the correction mechanism for the United Kingdom;
- the continuing existence of a degree of regressivity owing to the continuation of the VAT resource;
- unequal distribution among Member States of the revenue accruing from traditional own resources. Revenue from such resources appears to show a disadvantage for Belgium,

⁸ The maximum VAT call rate, set at 1% for 1999, was reduced to 0,75% in 2002 and 2003 and will be reduced to 0,50% as from 2004 in order to continue the process of taking account of each Member State's capacity to contribute to the EU budget and correcting the regressive features of the current system for the least prosperous Member States.

Ireland, the Netherlands and the United Kingdom. That situation is, however, largely attributable to the "Rotterdam effect", which links revenue at port of entry to the country bearing the economic cost of the duty, and is not therefore a real breach of equity.

The difficulties which the Community encountered in the eighties in bringing revenue up to the level required to meet increasing expenditure have now completely disappeared owing to the combined effect of two factors:

- the introduction of the GNP resource and its use as an adjustment variable: it is not, in fact, based on a well-defined tax base but on Member States' overall budgetary capacity;
- the efforts made in the nineties to control expenditure: since 1996 the result has been a growing positive gap between the own resources ceiling and the expenditure ceiling, and to an even greater degree between the own resources ceiling and the actual budget. In 2001 these disparities amounted to 0,16% and 0,20% of Community GDP respectively.

Yet traditional resources pose a problem with regard to the *cost-effectiveness ratio of the Community's own resources*. Collection is a matter for the Member States and is very complex with a high risk of fraud and irregularity⁹. On the other hand, the collection of the VAT resource, and more especially the GNP resource, together representing more than 80% of total resources, costs very little.

In some respects, the present system nevertheless does have significant failings in terms of financial autonomy and transparency/simplicity. The bulk of the Union's resources comes from national contributions, that is to say from Member States' public exchequers; that reduces the Union's financial autonomy but does ensure a good level of equity and a good cost-effectiveness ratio. Traditional own resources contribute to financial autonomy but their equity is open to question, and recovery and control are both very complex.

⁹ Note, however, that, even if the proceeds from these duties were not an own resource, Member States would have to apply customs union rules and would be facing the same difficulties.

- (a) While the Union's financial autonomy is a legal reality, the major part of own resources takes the form of transfers charged to national budgets. Traditional own resources are at present the European Union's only true own resource. Its share of total resources has been in steady decline. Moreover, even though customs duties and related financial flows are the result of Community commercial policy, the Member States collecting them have a tendency to regard them as national contributions. That increasing Community dependence on transfers from national budgets means that the question of Union financing cuts across national budget policies and feeds into Member States' claims in terms of national benefit from the Community budget, difficult though it may be to define such a concept.
- (b) The transparency and simplicity of the system are not satisfactory. The calculation of contributions due under the VAT resource has a twofold shortcoming. One, it makes the amounts collected dependent upon statistical calculations (mainly the estimate of the weighted average rate) which construct a fictitious tax separate from the tax actually paid by taxpayers in each Member State. Two, capping of the VAT resource for an increasing number of Member States turns it into a *de facto* GNP resource¹⁰. Moreover, the correction for the United Kingdom plays a part in masking the precise nature of the system and its consequences. More generally, the predominance of the GNP resource has the effect of revealing the national origin of resources and masking the categories of taxpayer involved.

¹⁰ Under the own resources Decision of 24 June 1988, the assessment base for each Member State could not exceed 55% of its GNP. The own resources Decision of 31 October 1994 capped the VAT assessment base at 50% of GNP as from 1995 for Member States whose per capita GNP was below 90% of the Community average (Spain, Greece, Ireland and Portugal). That provision was implemented in equal stages for the other Member States over the period 1995 to 1999 (54% in 1995, 53% in 1996, 52% in 1997, 51% in 1998 and 50% in 1999). In the own resources Decision of 29 September 2000, the VAT assessment base was capped at 50% of GNP for all Member States. Capping is a result of the determination to improve the regressive aspects of the VAT resource, which is regarded as imposing a disproportionate budgetary penalty on the least prosperous Member States.

THE DECISION-MAKING PROCESS

Article 269 TEC, in its present form, provides for the unanimous adoption of the provisions relating to the system of own resources of the Union but these are not mandatory provisions, as the Council is merely recommending that the Member States ratify them. One may therefore wonder whether this procedure is able to guarantee in the future the adoption of the measures required for the financing of Union policies, bearing in mind "the weight of numbers". Will it, in fact, always be possible, in an enlarged Union, to ensure funding via a decision which must be adopted unanimously and ratified by all the Member States?

A second question may also be asked as to whether the procedure currently provided for in Article 269 TEC would allow the system to move beyond national contributions to autonomous resources. A considerable number of Convention members propose that the Constitution provide for the possibility of a European tax or participation in national taxes, without this leading to any increase in the tax burden on citizens. It would primarily be a question of the need for transparency: European citizens should know how and to what extent they are financing the Union.

It should also be pointed out that the structure of Article 269 TEC is in line with the philosophy of international treaties. The Convention, on the other hand, is informed by a constitutional approach designed to enable the Union to fulfil its tasks on the basis of the double State/citizen legitimacy.

It should, however, be noted that any change in procedure involving the abolition of the national ratification requirement would entail creating a new Union competence which would have to be taken into account in Part Three of the Constitution.
