EUROPEAN COMMISSION

Brussels, 27.10.2011
SEC(2011) 876 final/2

Corrigendum : annule et remplace le document SEC(2011) 876 final
Concerne uniquement la version EN - page 12 et page 21

COMMISSION STAFF WORKING PAPER

FINANCING THE EU BUDGET: REPORT ON THE OPERATION OF THE OWN RESOURCES SYSTEM

Accompanying the document

Proposal for a Council Decision

on the system of own resources of the European Union

{COM(2011) 510 final}

EXECUTIVE SUMMARY

In accordance with the conclusions of the European Council of 15-16 December 2005, the Commission presented "*a full, wide-ranging review covering all aspects of EU spending, including the Common Agricultural Policy, and of resources, including the United Kingdom rebate*"[1] in the EU Budget Review[2].

The Budget Review highlighted that the current financing system is perceived as both opaque and complex, as lacking in fairness – notably with regard to corrections – and as relying excessively on resources which are perceived as expenditure to be minimized by the Member States. With the exception of customs duties stemming from the customs union, existing resources do not display a clear link to EU policies.

Hence it noted that introducing a new phase in the evolution of EU financing could provide gains in three closely linked dimensions – the simplification of Member States' contributions, the introduction of one or several new own resources and the progressive phasing-out of all correction mechanisms. As these changes are phased in, the essential elements of the EU financing system should be retained: a stable and sufficient financing of the EU budget, respect for budgetary discipline and a mechanism to ensure a balanced budget.

It also underlined that a reform of the way the EU budget is financed "*is not an argument about the size of the budget – it is a debate about the right mix of resources. The progressive introduction of a new resource would open the door for other resources to be reduced, phased out or dropped*".

This own resources report presents an in-depth and systematic technical analysis of the issues and possible options for reform of the EU financing system identified in the Budget Review. This analysis underpins the concrete proposals made by the Commission in the draft own resources Decision and its accompanying implementing regulations[3].

The proposals developed here aim to bring the financing mechanisms closer to those designed by the founders of the Union, which encompassed in particular the principle that "*the budget shall be financed wholly from own resources*", such as customs duties collected on the basis of the common custom tariff. The current dominance of own resources perceived as national contributions does not reflect the special character of the EU which is not a simple club of different members that are paying their membership fees.

At the same time the proposals aim to establish a link between the revenues of the EU-budget and commonly agreed EU policy objectives. It should also be stressed that proposals for new own resource have no impact on national sovereignty.

[1] See Declaration 3 to the Interinstitutional Agreement between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management, 2006/C 139/01, 14.6.2006.
[2] See COM(2010)700 of 19.10.2010.
[3] See COM(2011) 511 final of 29.6.2011.

The report is organised in three parts.

Part I presents the main features and an assessment of the current financing system. It includes an analysis of the evolution of own resources and correction mechanisms over time, and a qualitative assessment of the system.

The financing system has evolved considerably over time, from a system of contributions from the Member States to a system of own resources, primarily based on traditional own resources at the start, then increasingly on a VAT-based own resource and, more recently, on a GNI-based own resource. Today, the bulk of EU financing relies on the GNI-based and the VAT-based own resources, which are statistical aggregates and display no link to EU policies. Both own resources are widely perceived as national contributions.

In parallel to the evolutions in the composition of own resources, an increasing number of correction mechanisms have been developed, based on principles set out at the Fontainebleau European Summit in June 1984 according to which "*any member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time*". Mechanisms of corrections, and numerous exceptions, can be found both on the expenditure and the revenue sides of the budget. The most important of these mechanisms is the UK correction, and the "rebates on the rebate" to the benefit of Germany, the Netherlands, Austria and Sweden. In addition, reductions of the GNI-based contributions have been granted to the Netherlands and Sweden for the period 2007-2013. These two countries, as well as Germany and Austria also benefit from temporary reductions for the same period on the call rates on the VAT-based own resource. These mechanisms are very complex and lack transparency. They lead to a widespread perception that the EU financing is unfair.

An assessment of the system highlights that the current financing system allows a sufficient and stable financing of the EU. The GNI-based own resource plays the central role in allowing a balanced budget but this could be achieved with a much smaller (indeed residual) resource and with a fundamentally different mix of resources. A genuine advantage of the current system relates to the limited administrative costs. The GNI-based and VAT-based contributions also create a direct link between the national budgets and the EU budget thus potentially contributing to financial discipline at the EU level. However, this link would still be effective if these resources constituted a much smaller share of the EU budget.

The current financing system performs poorly with regard to all other relevant criteria. It contributes to an increasing focus Member States place on a narrow 'accounting' approach with the main objective of maximising financial returns from the EU budget. This has led to tensions between them and has distorted the public debate about the value of EU spending and, in some quarters, about the benefits of EU membership itself.

The Treaty on the Functioning of the European Union (TFEU) introduces important changes, not only for EU budgetary procedure, but also the way the EU budget is financed. Article 311(3) TFEU opens the door to reducing the number of existing resources and to creating new ones. The new Article 311(4) TFEU introduces the possibility of defining specific implementing measures related to the own resources system in an implementing regulation within the limits set out by the own resources Decision. This new framework creates an opportunity to make the own resources system sufficiently flexible within the framework and limits set out by the own resource Decision.

The recent financial crisis creates a new context which needs to be taken into account when designing the future architecture of the EU budget. The EU financing system could play a significant role in the Union-wide budgetary consolidation efforts. With the progressive introduction of new resources the need for Member States transfers to the EU budget would diminish and Member States would have an additional degree of freedom in managing scarce national resources.

It is therefore reasonable to envisage well-grounded alternatives to the existing system. Those are examined in the rest of the report.

Part II analyses the simplification of Member States' contributions and the introduction of new own resources. The analysis is underpinned by assessment criteria defined in the EU Budget Review and which allow a consistent and politically sound examination of reform options.

Eliminating the VAT-based own resource in parallel to the introduction of one or several genuine own resources would simplify the existing Member States contributions. The VAT-based contribution is complex, requires an important administrative work necessary to harmonize the calculation basis, and offers little or no added value compared to the GNI-based own resource. Furthermore, due to the statistical nature of the basis, the resource is fully independent of- and does not support VAT policies at EU or Member States level. This is why most Member States and EU institutions called for its elimination in the context of the Budget Review consultation. Considering the administrative complexities related to the current system and the low call rates currently in place, a step-by-step phasing-out would seem less effective than the complete elimination on a given date.

The analysis of the various potential candidates identified in the EU Budget Review as potential new own resources gave rise to a substantial technical work (see Annex to this report). It highlighted the following key elements:

– Financial sector taxation would constitute new revenue stream, therefore potentially reducing the existing contributions from Member States, giving an extra room for manoeuvre to national governments and contributing to general budgetary consolidation efforts. Although various forms of financial sector taxation can be observed in Member States, action at EU level could prove more effective and efficient, and it could play a role in reducing the existing fragmentation of the Internal market. A financial transaction tax that could be collected at EU level would also reduce the *juste retour* problems observed in the current financing system. An EU initiative in this area would constitute a first step towards the application of a FTT at global level. On the other hand, a financial activities tax would seem less suitable as an own resource as it would rely exclusively on national administrations for its collection and management. The debate on VAT policy following the VAT green paper later this year will be a most appropriate opportunity to discuss FAT as a compensation scheme for VAT exemption on financial services.

– Aviation sector taxation would share many of the advantages identified for the financial transaction tax. It would constitute a new revenue stream, lend itself to autonomous collection at EU level and constitute an effective response to the emerging tax-induced internal market fragmentation in this area. However, to the extent that the aviation sector will be affected by the Emission Trading System from 2012, introducing an aviation tax at EU level may not be appropriate at this stage.

- Resources based on emission auctioning in the context of the EU Emission Trading System (ETS) or a tax based on energy based on the revised Energy Taxation Directive would display strong links to emerging and rapidly evolving climate and energy priorities. They could be underpinned by a strong regulatory framework. Although these resources would stem from an existing system, with a revenue stream entering into national systems, autonomous revenue collection at the EU level could be envisaged in the medium- to long-term. Nevertheless, given the initial need of stability for the finely balanced new system of auctioning starting in 2013, no link to the EU own resources system is proposed for the time being.

- The development of a new VAT resource creating a genuine link between national VAT and the EU budget would be feasible. While revenue collection would rely exclusively on Member States administrations, such a system could provide significant and stable receipts to the EU with limited administrative costs for national administrations. This resource would not create a new VAT system parallel to the national ones, nor would it impose new charges on businesses or citizens. The introduction of a new VAT resource could form part of a broader reform initiated by the Commission's Green Paper on the future of VAT. Broadening the tax base, reducing the scope for fraud, improving the administration of the tax and reducing compliance costs in the context of a broad reform of VAT, could deliver important results and generate new revenue streams for the Member States. A fraction of the gains derived from this initiative could be attributed to the EU level, and these could be further increased as the VAT system improved its performance.

- The examination of the EU Corporate Income Tax (EUCIT) generated a host of conceptual and practical issues and was considered as unsuitable as a potential own resource for the foreseeable future.

Overall, based on this analysis, it appears feasible to introduce several new own resources at EU level beyond 2013. The introduction of new own resources could play a role in budgetary consolidation processes and lead to a new impetus in the European construction by facilitating reforms of the Internal market. It would be difficult to assess the combined impact of several resources on one specific Member State or on one specific economic sector.

Part III examines issues related to correction mechanisms and their simplification. The limitations of the current mechanisms are presented, together with alternative options.

A number of the correction mechanisms, introduced in the current own resources Decision, will automatically end in 2013. However, the rebate granted to the United Kingdom (UK correction) – and the related rebates on this rebate granted to Germany, The Netherlands, Austria and Sweden – has no expiration date.

At the time of its introduction the UK correction offered a response to what was clearly an inequitable situation whereby one of the poorest Member States was one of the largest contributors to the EU budget.

However, the underlying factors contributing to this particular situation have clearly evolved since the rebate was agreed in 1984 and the budgetary burden of the UK in relation to its relative prosperity is now more in line with that of other net contributors.

The UK correction and its financing arrangements ("rebates on the rebate") are fraught with complexity. The economic disincentive inherent to the mechanism potentially discourages the UK from spending EU money on its own territory. Finally a technical consideration: with the elimination of the current VAT-based own resource, essential data for calculating the UK correction will no longer be available.

The budgetary burden of the UK and its relative prosperity must be carefully assessed against the situation of other Member States on the basis of horizontal criteria and any proposal for the introduction or the continuation of corrections post-2013 must be rooted in an equitable approach across Member States.

The analysis demonstrates that transforming the current mechanism into a lump sum gross reduction on the GNI-based own resources payments would offer clear advantages compared to any alternative formula, including a generalised correction mechanism as was proposed by the Commission in 2004. A system of lump sums would be transparent and easy to understand, thus making it more open to public and parliamentary scrutiny; it would be fair, by treating large contributors to the EU budget in line with their economic prosperity, and ensuring a balanced financing of the corrections; its ex ante nature would ensure that Member States are not influenced by corrections when making spending decisions. Lump sums would be foreseen for the duration of one financial framework, thus ensuring the link between expenditure and revenue provided for in the Fontainebleau agreement.

Overall, the analysis shows that the simplification of the current contributions through the elimination of the VAT-based own resource, the parallel introduction of new own resources linked to EU policies, and the transformation of the existing correction maze, are strongly related and reinforce each other to achieve a major reform of the financing of the EU budget.

 EN

PART 1: AN OVERVIEW OF THE EU FINANCING SYSTEM

Part 1 presents first key facts about the own resources (section 1) and the correction mechanisms (section 2), including key legal and quantitative aspects of the EU financing system. A qualitative assessment of the system is presented in section 3, based on budgetary, EU integration, efficiency and equity criteria.

1. Key facts about own resources

1.1. Legal framework

Article 311 of the Treaty on the Functioning of the European Union defines the key principles regarding EU financing.

- First, "*without prejudice to other revenue, the budget shall be financed wholly from own resources*". The revenue of the general budget of the European Union can be divided into the own resources and other revenue.

- Second, the provisions relating to the system of own resources are set out in a decision - the own resources decision - adopted unanimously by the Council after consulting the European Parliament, in accordance with a special legislative procedure. In that context the Council "*may establish new categories of own resources or abolish an existing category"*. That decision "*shall not enter into force until it is approved by the Member States in accordance with their respective constitutional requirements*". This procedure preserves national sovereignty in tax matters.

- Third, the Treaty provides that the Council, acting by means of regulations in accordance with a special legislative procedure, and after obtaining the consent of the European Parliament, may lay down implementing measures for the Union's own resources system "*in so far as this is provided for in the [own resources] decision*".

In addition, Article 322§2 lays down provisions on the methods and procedures whereby the budget revenue provided under the arrangements relating to the Union's own resources "*shall be made available*" to the Commission.

1.2. Evolution over time

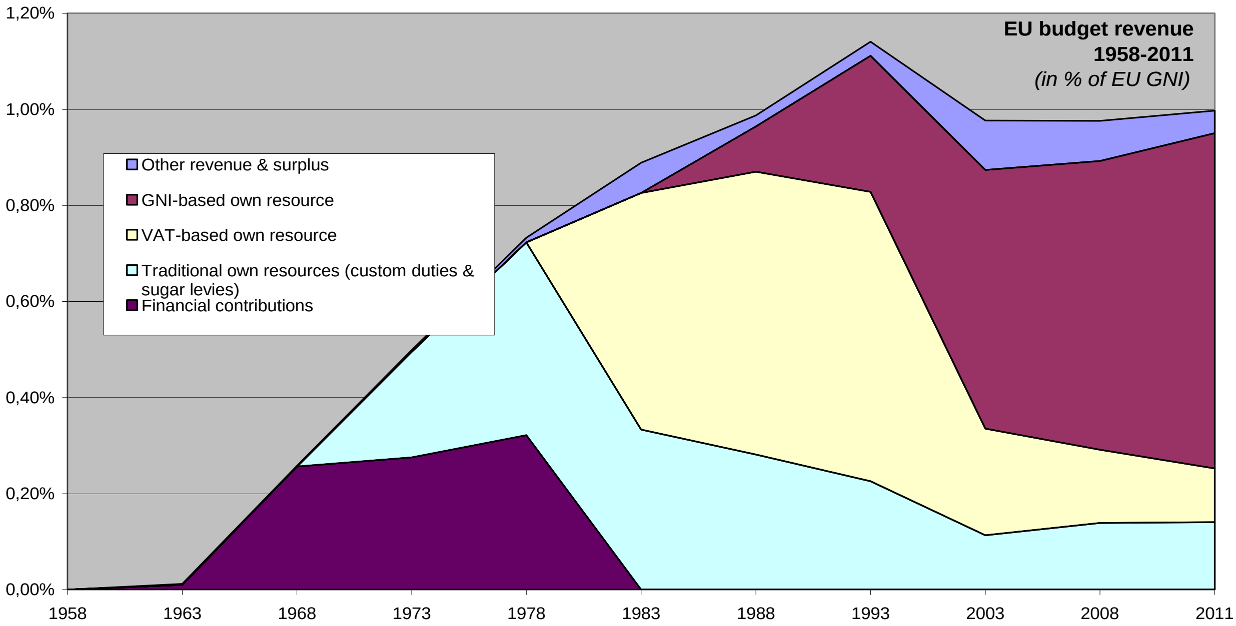
Just like the expenditure side of the budget, the structure of the financing side has evolved considerably over time. Six own resources decisions, of varying durations, have been adopted since 1970[4]. New own resources have been introduced and other revenue streams have disappeared or been reduced according to evolving circumstances.

As can been seen in graph 1, in the early years of the European Communities the financing system relied on *ad hoc* national contributions. These were progressively replaced by own resources defined in the own resources decisions and disappeared completely in 1982. Traditional own resources (customs duties and sugar levies) emerged in 1968 and constituted the largest part of the financing until the early 1990s. Their share declined markedly in subsequent years. The VAT-based own resource constituted a new income stream from 1979,

[4] Council Decisions EEC, Euratom No 70/243 of 21.4.1970, No 85/257 of 7.5.1985, No 88/376 of 24.6.1988, No 94/728 of 31.10.1994, No 2000/597 of 29.9.2000, No 2007/436 of 23.6.2007.

reaching a peak in the mid-1980s. Lastly, the GNI-based own resource was introduced in 1988 and now represents three-quarters of the budget revenue[5]. Other revenue represents only a very minor part of total financing[6].

Graph 1 – Structure of EU financing 1958-2011



Source: DG Budget, European Commission

The graph also illustrates that EU budget revenues expressed as a percentage of GNI have also fluctuated substantially. A peak was reached in the mid-1990s. Following a declining trend, recent years have witnessed a new increase, which reflects the impact of the crisis on EU GNI rather than a change in policy orientation for the EU budget.

In accordance with Article 310 of the Treaty, total EU revenue has to be equal to total expenditure and is required to stay within agreed legal limits, currently set at 1.29% of the EU GNI for appropriations for commitments and 1.23% of EU GNI for appropriations for payments. These ceilings are laid down in the own resources Decision and can therefore only be modified by unanimity and after ratification of the Member States. The actual level of expenditure/revenue is significantly below the current own resources ceiling.

[5] Gross National Income (GNI) is used as a reference for this resource since 2002. Over 1988-2001 Gross National Product (GNP) was used instead.

[6] See European Commission, *European Union Public Finance*, 4th Edition, OPOCE, Luxembourg, 2008, chapter 12.

Table 1: EU budget revenue 1970-2010 (% GNI)

	1970	1979	1988	1995	2004	2010
	EU-6	EU-9	EU-12	EU-15	EU-25	EU-27
VAT-based own resource (1)	---	0,38	0,59	0,58	0,13	0,10
GNP/GNI-based own resource (2)	---	---	0,10	0,21	0,65	0,75
Other payments from/to Member States (3)	0,78	---	---	---	---	---
Total national contributions (4)=(1)+(2)+(3)	0,78	0,38	0,68	0,80	0,78	0,85
Traditional own resources (5)	---	0,39	0,28	0,22	0,12	0,13
Total own resources (6)=(4)+(5)	0,78	0,77	0,96	1,01	0,90	0,97
Surplus from previous year (7)	---	0,00	0,01	0,10	0,05	0,02
Other revenue (8)	0,00	0,01	0,01	0,01	0,03	0,05
TOTAL REVENUE (9)=(6)+(7)+(8)	**0,78**	**0,78**	**0,99**	**1,12**	**0,98**	**1,05**

1.3. Situation today

There are now three main categories of own resource: traditional own resources, the VAT-based resource and the GNI-based resource. These are supplemented by various correction mechanisms[7]:

- The first own resource ("traditional own resource" or TOR) mainly consists of customs duties and some resources of agricultural origin (sugar levies). Since 2001, a 25 % flat-rate deduction is retained at source by the Member States by way of collection costs. Before that, the percentage retained was 10%. TOR represents 14.1 % of the total EU revenues in the 2011 budget[8] (see Table 2).

- The second resource results from the application of a uniform rate to Member States' value added tax (VAT) bases. The uniform rate is set at 0.30%. However, this percentage has been reduced for 4 Member States (Austria, Germany, the Netherlands and Sweden) for the period 2007-2013 only. Where a Member State's VAT base is greater than 50 % of its GNI the uniform rate is applied to a base equivalent to 50% of GNI_(capping). Six Member States (Ireland, Cyprus, Luxembourg, Malta, Portugal and Slovenia) are expected to have their VAT base capped in 2011. The VAT-based own resource represents 11.2 % of revenue in the budget 2011.

- The third resource, the "additional" resource, results from the application of a uniform rate to Member States' GNI bases; calculated in such a way as to cover the balance of total expenditure not covered by the other resources. Gross annual reductions in GNI payments are granted to Sweden and the Netherlands for 2007-2013 only. The GNI-based own resource represents 70.0% of revenue in the budget 2011.

[7] The EU financing system has been modified with the entry into force on 1.3.2009 of the Own Resources Decision 2007 (2007/436/EC, Euratom - OJ L 163 of 23.6.2007).
[8] Amending budget 4/2011.

Table 2: breakdown by type of revenue

Type of revenue	Budget 1988		Budget 2000		AB 4/2011	
	EUR billion	Share %	EUR billion	Share %	EUR billion	Share %
Customs duties and sugar levies	11.9	29	15.3	17	17.9	14.1
VAT own resource	24.9	60	35.2	38	14.1	11.2
GNI own resource	4.2	10	37.6	41	88.6	70.0
Other revenue (incl. surplus)	0.9	1	4.8	5.1	5.9	4.7
Total	**41.8**	**100**	**92.7**	**100**	**126.5**	**100**

Source: EU budget Financial Report & Amending Budget 4/2011

A summary of financing of the general budget by class of own resource and by Member State for the amending budget 4/2011 can be found in Annex 1.

2. Key facts about the correction mechanisms

2.1. Legal context

Unlike own resources, correction mechanisms are not provided for in the Treaty but result from political agreements. They were first introduced in the 1980s to solve, it was hoped, problems related to budgetary imbalances.

The 1984 Fontainebleau European Council conclusions set out the core principles behind the existing system of corrections. First, "*expenditure policy is ultimately the essential means of resolving the question of budgetary imbalances*". Second, "*any member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time*".

2.2. Evolution over time and the situation today

Since the 1984 Fontainebleau agreement several permanent or temporary correction mechanisms have been introduced. The most important correction mechanisms are on the revenue side. They are a collection of diverse measures resulting from a series of successive negotiations. An own initiative resolution of the European Parliament ("the Lamassoure resolution") identified 41 exceptions introduced by the European Council in December 2005 on the expenditure and revenue sides of the budget[9].

On the expenditure side, numerous *ad hoc* payments have been granted to individual Member States or regions over the years (see Annex 2). In practice, Member States benefiting from redistributive packages, such as cohesion policy aiding poorer regions, see their benefit reduced through increased contributions to the budget to finance the corrections on the revenue side. Some of the corrections on the expenditure side in turn increase the UK correction.

However, the most important correction mechanisms are to be found on the revenue side:

[9] See European Parliament resolution of 29 March 2007 on the future of the European Union's own resources (2006/2205(INI)) - P6_TA-PROV(2007)0098.

- The UK correction agreed by the 1984 Fontainebleau European Council and its financing. Although the mechanism has been modified in successive own resource decisions its basic principle remains unchanged, namely to reimburse the UK with 66% of the difference between what it pays to the EU budget (except TOR) and what it receives from the budget[10]. The financing of the UK correction has also been modified over time, extending and reinforcing what are commonly known as "the rebates on the rebate" to the traditionally most important net contributors to the EU budget[11]. The December 2005 European Council decided to adjust the UK correction so that non-agricultural expenditure in the 12 Member States that acceded to the Union in 2004 and 2007 is no longer included in its calculation base[12].

  The amount to be entered in the 2012 budget for the ‘correction of budgetary imbalances in favour of the United Kingdom’ (UK correction) is EUR 3.8 billion. The calculation is shown in table 4 below.

  Germany, the Netherlands, Austria and Sweden benefit from a reduction in their share in the financing the UK correction.

Table 4: calculation of the UK correction for the year 2011 (EUR million)

(1)	UK share of total uncapped VAT base	15.0054%
(2)	UK share of enlargement-adjusted total allocated expenditure	7.6164%
(3)	= (1) - (2)	7.3890%
(4)	Total allocated expenditure	114,982.0
(5)	Enlargement-related expenditure = (5a) + (5b)	29,243.0
(5a)	*Pre-accession expenditure*	3,047.7
(5b)	*Expenditure related to Art 4(1)(g)*	26,195.2
(6)	Enlargement-adjusted total allocated expenditure = (4) - (5)	85,739.0
(7)	UK correction original amount = (3) x (6) x 0.66	4,181.2
(8)	UK advantage	319.4
(9)	Core UK correction = (7) - (8)	3,861.7
(10)	Traditional Own Resources (TOR) windfall gains	61.3
(11)	UK correction = (9) - (10)	3,800.4

Source: Draft Budget 2012

- Germany, the Netherlands, Austria and Sweden benefit from a reduction in the call rates for the VAT-based own resource. While Member States normally contribute 0.3% of their VAT assessment base to the EU budget, the rate of call is reduced for Austria (0.225%), Germany (0.15%), the Netherlands (0.10%) and Sweden (0.10%) for the period 2007-2013.

[10] Any benefit or cost for the UK resulting from modifications introduced in the successive own resources decisions has been neutralized.
[11] Since 2001, Germany, Austria, the Netherlands and Sweden pay only 25% of their normal financing share of the UK correction (Germany paid 2/3 of its normal financing from 1985 until 2000).
[12] The maximum cost to the UK of this measure cannot exceed EUR 10.5 billion (in 2004 prices) over the period 2007-2013. The actual cost of this measure for the UK will most likely be much lower.

- The Netherlands and Sweden receive a gross reduction in their annual GNI contributions for the period 2007-2013 only. In current prices, these gross reductions for 2011 amount to EUR 665.0 million for the Netherlands and EUR 164.9 million for Sweden[13].

Table 3 presents the direct impact of these various corrections in the draft budget 2012[14].

Table 3: Impact of correction mechanisms granted to Germany, the Netherlands, Austria and Sweden (EUR million)

	Impact of reduced VAT call rates	Impact of lump sum GNI reduction	Impact of reduced share in UK correction financing	Combined impact
Germany	1,143.7	-174	681.1	1,650.9
Netherlands	437.7	638	160.4	1,236.1
Austria	38.9	-20	76.6	95.6
Sweden	261.9	142	103.7	507.6

Source:,DG Budget calculations based on draft budget 2012

- Finally, Member States retain a fixed percentage of all traditional own resources collected. This percentage was fixed at 10% when these resources were first transferred to the EU budget in the early 1970s. In 1999 the Berlin European Council decided to increase it to 25%. These retained amounts do not correspond to actual collection costs and can be considered a hidden correction mechanism.

3. Assessment of the current EU financing system

3.1. Assessment criteria

Reviewing the current financing system and then proposing reforms thereto requires robust assessment criteria. It is useful to identify not only the main pros and cons related to the constituent elements of a financing system – that is, the individual own resources as well as the correction mechanisms –, but also to the system as a whole, taking into account the interrelation between these elements. Parts 2 and 3 of this report propose specific assessment criteria for individual own resources and corrective mechanisms, respectively, whereas this section focuses only on criteria for assessing the financing system as a whole.

[13] The Netherlands EUR 605 million and Sweden EUR 150 million in 2004 constant prices. These amounts are converted to current prices every year, using the GDP deflator.

[14] The impact of these corrections on the UK correction calculation in 2013 is not included.

The existing system can be assessed using four main categories of criteria[15]:

- Budgetary criteria: ensuring a sufficient and stable EU financing and budgetary discipline.
- Integration criteria: ensuring financial autonomy, transparency and a link to EU policies. Another important aspect of this criterion is the principle of fiscal equivalence for the provision of (public) goods and services - that primarily those individuals benefiting from certain spending programmes should also be those financing it.
- Efficiency criteria: internalising externalities, implementing the subsidiarity principle, limiting operating costs.
- Equity criteria: ensuring fairness at the level of Member States plus horizontal and vertical equity for the taxpayers.

3.2. Budgetary criteria

The existence of a GNI-based residual contribution in combination with the Inter-institutional agreement[16], and not least the existence of a multiannual financial framework has ensured budgetary discipline and smooth adoption of the EU budget since 1988. The size of the EU budget is now constrained by agreements on expenditure rather than by scarcity of funding. This contrasts with the situation observed in the past[17].

It should be noted, however, that this good performance regarding budgetary criteria is, to a large extent, independent from the mix of own resources and the correction mechanisms. The same budgetary performance could be achieved were there to be a very small residual GNI-based contribution (or another type of residual contribution) in combination with a radically different mix of own resources.

3.3. Integration criteria

The financial autonomy of the Union is limited. The two largest sources of revenue – the VAT- and GNI-based own resources – display many of the characteristics of national contributions and are often perceived as such. They are provided by national Treasuries and are sometimes presented as an expenditure item in national budgets. This inevitably creates a tension which poisons every EU budget debate. National politicians often tend to judge EU policies and initiatives in terms of returns compared to their national contributions, rather than looking first at the overall value of pursuing certain policies at the European level. As a consequence, preference is often given to policies with pre-allocated expenditures at the expense of policies with potentially higher EU added value. Moreover, increasingly complex correction mechanisms have been developed in response to demands of net contributors to the EU budget. Overall, it can be argued that the increasing difficulties encountered in achieving

[15] See, for instance, Cattoir, Ph. (2009), "Options for an EU financing reform", *Notre Europe*, Paris and Heinemann, F., Mohl, P. and S. Osterloh (2008), "Reform options for the EU own resource system", Research project 8/06 commissioned by the German Federal Ministry of Finance, ZEW, Mannheim, 18 January 2008.
[16] Inter-institutional Agreement of 17 May 2006 between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management - Including the multiannual financial framework 2007-2013 (OJ C 139 of 14.06.2006)
[17] See European Commission (2008c), chapter 2 *et sq*.

agreement on budgetary matters in the EU result partly from the way the EU budget is financed.

The financing system is both opaque and very complex. As a result, it is almost impossible for EU citizens to ascertain who effectively bears the cost of financing the EU. Issues arise, in particular regarding the VAT-based own resource (see Part 2.1). Furthermore, the EU budget is often presented as "*an insatiable and very costly Leviathan, sucking national resources to finance useless, or even harmful policies that benefit a few well-organized lobbies of producers – but when it comes to how much it actually levies on individual taxpayers, the amount quoted are usually grossly exaggerated*"[18].

Lastly, except for traditional own resources the current financing sources of the Union do not contribute to - or support EU policies. Some alternative own resources could contribute to achieving key EU policy objectives. As indicated in the EU Budget Review, the "*introduction of new own resources would mirror the progressive shift of the budget structure towards policies closer to EU citizens and aiming at delivering European public goods and a higher EU added value. It could support – and be closely linked to – the achievement of important EU or international policy objectives, for instance in relation to development, climate change or the financial markets.*"

3.4. Efficiency criteria

On the one hand, the operating costs of the current system are very limited. Customs and the other duties included in traditional own resources (TOR), and VAT would be charged and collected by Member States regardless of whether or not there was an own resources system. Similarly Member States would need to calculate their GNI even if there was no GNI-based own resource. For TOR, the costs of maintaining the Customs Union, one of the foundations on which the EU is based, are not relevant. Only the passing-on by Member States of TOR revenue collected (less a portion retained "by way of collection costs") are requirements directly related to own resources. For the VAT- and GNI-based own resources, the only direct costs are those purely administrative costs related to the calculation of the resource and the payment of the corresponding revenue to the Commission. All the costs related to the national collection of VAT and to recording GNI are not costs of the own resources system as such and should therefore not be taken into account as administrative costs related to the own resources system.

Overall, the costs which devolve upon the Commission and Member States resulting from the need to manage the own resources system have not been quantified. However a qualitative analysis suggests they are likely to be marginal, particularly as the extra requirements (resulting directly from the fact that the revenue concerned is an own resource) are few and are usually very limited in scope.

On the other hand, contrary to market-based instruments, the VAT- and GNI-based contributions do not provide incentives to economic agents and, though the resource administration costs are marginal, there is no dividend from the European dimension. As discussed in Part 2 of this report, the use of alternative financing sources at EU level could

[18] See Begg, I., Enderlein, H., Le Cacheux, J. and M. Mrak (2008), "Financing of the European Union Budget", Study for the European Commission, Directorate general for Budget (contract N°30-CE-0122101/00-72, 29 April 2008.

lead to efficiency gains in the form of reduced administrative costs or by taking into account cross-border externalities.

3.5. *Equity criteria*

Many Member States still perceive their contributions to- or benefits from the EU budget as being unfair[19]. Among the numerous inconsistencies and problems related to the correction mechanisms, it is useful to bear the following issues in mind:

– The unique situation which led to setting up the UK rebate no longer prevails. The combination of low relative prosperity and an excessive budgetary burden which characterized the UK's relative position compared to other Member States in the 1980's has gradually faded away.

– The corrections on the revenue side partially undo the impact of certain expenditure policies. It appears at best inconsistent that Member States benefiting from redistributive packages to poorer regions through the cohesion policy see their benefit reduced through increased contributions to the budget to finance the corrections on the revenue side. Some of the corrections on the expenditure side would in turn increase the UK correction (and impact on rebates on its financing for some Member States). Finally, some Member States receive corrections on both sides of the budget.

– The capping of the VAT-base (at 50% of GNI) is supposed to remedy the regressive aspects of the VAT-based own resource, which is seen as disproportionately penalising the less affluent Member States. However, in practice, the size of the VAT base is not proportional to Member States' GNI. Some of the richest Member States, such as Luxembourg and to a lesser extent Ireland, are subject to capping and thus see their contributions reduced. Furthermore, some doubts are raised as to the regressive character of the VAT at national level (see Annex to this report).

– The justification for allocating 25% as "collection costs" for traditional own resources is weak. While the 10% retained until 2000 could reasonably be considered to be compensation for expenses incurred by Member States (customs and audit services,…), this is not the case for 25%, which was agreed to allow certain Member States to decrease their payments to the EU budget. For those Member States which collect a large share of customs duties at important EU entry points, an increase of the collection costs represents a net decrease in their financial contribution to the EU budget since the increase in their GNI contribution is smaller than the increase in the collection costs retained. This notably benefits Belgium (entry point of Antwerp), the Netherlands (Rotterdam harbour) and to a lesser extent Denmark (Copenhagen harbour).

Overall, the focus on *juste retour* issues is probably an important factor explaining why the financial solidarity (total net transfers as a percentage of GNI) operated through the EU budget has decreased over time[20].

---

[19] The contribution of the Polish government to the budget review (9.4.2008, pp. 8-9) states, for instance, that "*an increase of contributions to the EU budget based on GNI reinforces the pressure on increasing the total size of rebates granted to most affluent member states... the applied correction mechanisms of the Community own resources system is of degressive character, imposing greater burdens on less affluent member states and citizens. Degressive character of own resources system results from [the] existence of rebates.*"

Besides, it should be borne in mind that, even if GNI probably correlates better with economic prosperity than any specific tax, it is a somewhat crude and imperfect tool[21]. Apart from methodological issues, there are also practical measurement problems, illustrated for instance by the considerable revaluation (around 10 %) of the Greek GNI series in mid-2007. Overall, as with most statistical indicators, the harmonization of "*macro-economic statistics… could still be improved*"[22]. It should also be noted that agreed improvements in GNI measurement are not easily applied to the calculation of own resources as is shown from the lengthy discussions on FISIM[23].

4. Views of the stakeholders – public consultation

Many stakeholders expressed their views on the current as part of the Budget Review consultation which took place in 2007-2008.

The following sections present an abstract of the summary of the contributions received for consultation[24]. The Commission received close to 300 contributions reflecting a broad range of opinions and perspectives. It is not a comprehensive account of all the interesting ideas expressed in the consultation but it does convey a broad sense of the most recurrent themes and issues raised at the time.

It is important to keep in mind that the following represents a snapshot of views expressed before the financial and economic crisis fully hit the European economy. In view of considerable economic and budgetary adjustments required since then, public finances in the EU have evolved significantly and the views of stakeholders have also changed in many countries.

4.1. Reform of the own resources system

"The guiding principles most frequently mentioned for the own resources system are fairness, effectiveness, simplicity, transparency, equity, sufficiency of means, sustainability and stability.

Two main options for systems to finance the EU command considerable support: moving towards a system exclusively based on Traditional Own Resources (TOR) and the resource based on Gross National Income (GNI); or moving away from a contributions-based system towards a system based on a new own resource. Although many Member States highlight the merits of GNI-based contributions, an increasing number of them also express their readiness

[20] See Richter, S. (2008), "Facing the monster *'juste retour'*: on the net financial position of Member States vis-à-vis the EU budget and a proposal for reform", wiiw Research Reports, 348, May 2008.

[21] Measurement problems can notably arise in the following areas: the underground economy; capital gains and losses; household services; volunteer work; non-renewable natural resources; imputed elements; commuters/cross-border work. See Aubut, J. and F. Vaillancourt (2001), *Using GDP in Equalisation Calculations: Are there Meaningful Measurement Issues?, October 2001.*

[22] Contribution of the European Court of Auditors to the budget review consultation, §26, 9 April 2008.

[23] See Council Regulation No 448/98, which completed and amended the European System of Accounts (ESA 95, as laid out in Commission Regulation No 2223/96 subsequently modified) and which was included in the own resources system only as of 2010 (Council Decision No 2010/196 of 16.3.2010).

[24] See SEC(2008)2739 of 3.11.2008. The contributions can be found on the following webpage: http://ec.europa.eu/budget/reform/issues/read_en.htm

to discuss other options based on an alternative financing source. There are very few negative opinions on Traditional Own Resources, which is a well known and accepted part of the financing system. Some draw attention to the fact that the collection fees retained by the Member States do not correspond to effective costs incurred and call for their reduction or elimination."

"A large number of respondents indicate that eliminating the resource based on a statistical value added tax (VAT) could contribute to a more transparent and simple financing system, without greatly affecting its current functioning. A clear majority of Member State governments would be in favour of such a reform. Many other respondents share this view. Active support for maintaining the VAT-based resource is very limited. Some suggest to end it in the context of a broad reform encompassing the development of new own resources. Many respondents express their satisfaction with the GNI-based resource: it is seen as fair, transparent and relatively simple. As a residual resource, it contributes to a smooth budgetary process with balanced budgets. In many cases, the respondents wish that the GNI-based contribution be expanded further – mostly at the expense of the VAT-based resource."

"Many respondents support the idea of financing a larger part of the EU budget with new own resources. While recognizing that this would raise a number of technical and political issues, many (among them also a significant number of Member States' governments) indicate that they are open for discussion. The development of new own resources is the most favoured approach regarding the reform of the financing system for all categories of respondents with the exception of the Member States' governments, albeit with different views over what kind of new resource might be desirable. On the other hand, a number of respondents, in particular among the Member States, explicitly reject the idea of creating an EU tax to finance the EU budget. However, with very few exceptions, they do not put into question the existing acquis, notably the fact that customs duties are an important source of EU financing. When alternative non-tax based own resources are mentioned, very few stakeholders explicitly reject them."

"Various potential alternative own resources are mentioned, often in relation to the acquis or to specific EU policies. Resources related to the environment and in particular climate change are among the most prominent candidates. More specifically, contributors refer to the allocation of all or part of the revenue from emission trading; CO_2 *or carbon taxation; energy, petrol, fuel or kerosene taxation; flight duties, maritime transport taxation and vehicles taxation. Resources based on VAT or financial transaction taxation are both mentioned by several contributors. In a number of cases, respondents suggest that a progressive approach would be needed to develop a new financing source of the budget."*

4.2. Corrections

"There is very heavy opposition among all categories of contributors against any kind of corrections, exceptions or compensations. The clear majority view is that abolishing existing exceptions and correction mechanisms is an indispensable step in making the EU budget more equitable and transparent. Only a small minority of Member States are in favour of maintaining corrections or introducing new ones. However, some respondents point to the political difficulty of removing all correction mechanisms and suggest that all Member States should at least be treated equally in this respect. According to a small number of contributors, mainly from one Member State, a way to do so would be a generalised correction mechanism or a more limited variant based on some elements of the budget."

"Several respondents express their scepticism with regard to the possibility of eliminating all correction mechanisms while further developing the GNI-based resource. They base their views on the observation that there used to be a strong parallelism in the past between the development of national contributions and the increase in the number and amount of corrections."

4.3. Future financing model

"Overall, several models seem to be considered. The most popular one among Member States is a model based on GNI with the elimination of all corrections and the elimination of the VAT-based contribution. A minority model among Member States would be to develop alternative financing sources while also eliminating all the corrections. Some Member States suggest that this could come as a second step after extending the GNI-based resource or in a longer term perspective. The two models are found in close proportions in the responses of other public bodies, while the latter is clearly favoured by NGOs, academics and other respondents. Respondents from academia or other types of respondents often favour the development of alternative own resource."

The public consultation on the Budget Review was followed by a large conference bringing together stakeholders, academics and prominent political representatives. One session examined how to reform the existing EU financing system[25]. The debates centred on the assessment of existing resources, the merits and possible problems related to alternative resources and the issue of corrections. The possible contribution of alternative resources was discussed with regard to, notably, broader tax policy objectives, the link to existing EU policies and the EU *acquis*, the reform of EU spending and the debate on *juste retour*. Particular attention was paid to resources related to climate/energy, corporate income, VAT and other indirect taxes. Correction mechanisms were widely criticized.

The debate with participants focused mainly on the type of new genuine own resource to introduce, e.g. VAT, capital income tax; the fiscal neutrality needed, regressivity/progressivity issues and citizens support. The necessity to reinforce the independence of the EU budget vs. national budgets (with a crucial role of the EP in this respect) and the urgency of reform (20 years after the introduction of the "temporary" GNI resource, it is time to stop endless debate on the quest for a "perfect" new genuine own resource) were underlined.

5. Arguments for a reform – policy context

Overall, the above analysis highlights the following driving elements and justifications for a reform of the EU financing system.

[25] See http://ec.europa.eu/budget/reform/conference/programme_en.htm

5.1. *The EU financing system is outdated*

The EU financing system has evolved considerably since 1957 from national contributions to a financing mainly based on statistical aggregates, which display no link to EU policy priorities (see section 1).

In parallel, a collection of correction mechanisms have been introduced based on principles set out at the Fontainebleau European Summit in June 1984 (see section 2).

As a result of these evolutions, the current financing system performs poorly with regard to most assessment criteria. The financing system is opaque and complex. This limits democratic oversight of the system. Many Member States perceive the system to be unfair. More importantly perhaps, the way the EU budget is financed creates a tension which poisons every debate about the EU budget. It also leads some people to question the benefits of EU membership itself (see section 3).

For many years, EU financing has primarily been treated as an accounting mechanism with two main objectives: ensuring sufficient financing of EU expenditures and incorporating the increasing number of correcting mechanisms. This approach has now reached its limits.

5.2. *The Lisbon Treaty creates a new legal framework*

The Treaty on the Functioning of the European Union (TFEU) introduces important changes, not only for EU budgetary procedure, but also the way the EU budget is financed (section 1):

- Article 311(3) TFEU now provides that the Council "*may establish new categories of own resources or abolish an existing category*" in the context of an own resources Decision. This opens the door to reducing the number of existing resources and to creating new ones.

- Article 311(4) TFEU newly provides that the "*Council, acting by means of regulations in accordance with a special legislative procedure, shall lay down implementing measures for the Union's own resources system in so far as this is provided for in the [own resources] decision*". This provision introduces the possibility of defining specific implementing measures related to the own resources system in an implementing regulation within the limits set out by the own resources Decision.

This new framework creates an opportunity to make the own resources system sufficiently flexible within the framework and limits set out by the own resource Decision.

5.3. *The EU financing system needs to be adapted to a new environment*

Except for the traditional own resources, the EU resources currently display almost no link to - nor do they support - EU policy objectives (see section 3). This led numerous contributors to the public consultation to promote new own resources based on the *acquis* and, in particular, emerging EU policy priorities (see section 4).

At the same time, important elements of the current financing system need to be preserved, such as the traditional own resources and a residual GNI-based own resource permitting budgetary stability and a balanced budget. But the latter can be achieved with a smaller, residual GNI-based own resource and with a fundamentally different mix of resources (see section 3).

Besides, the recent financial crisis creates a new context which needs to be taken into account when designing the future architecture of the EU budget. EU financing system could play a substantial role in the Union-wide budgetary consolidation efforts. Five heads of States or governments stressed that "*the next multiannual financial framework will come as Member States make extraordinary efforts to clean up public finances*"[26].

Developing the own resources system could contribute to the wider budgetary consolidation efforts undertaken by Member States. The progressive introduction of new resources could open the door for other resources to be reduced, phased-out or dropped. As a result Member States contributions to the EU budget would diminish and Member States would have an additional degree of freedom in managing scarce national resources. As indicated in the EU Budget Review, introducing new own resources "*is not an argument about the size of the budget – it is a debate about the right mix of resources*".

[26] Letter from David Cameron, Angela Merkel, Nicolas Sarkozy, Mark Rutte and Mari Kiviniemi to the President of the European Commission on 18 December 2010.

ANNEX 1

Summary of financing of the general budget by class of own resource and by Member State – Budget 2011* *(in EUR)*

Traditional own resources (TOR)				VAT- and GNI-based own resources						Total own resources
Net sugar sector levies (75 %)	Net customs duties (75 %)	Total net traditional own resources (75 %)	p.m. Collection costs (25% of gross TOR)	VAT-based own resources	GNI-based own resources	Reduction in favour of Netherlands and Sweden	United Kingdom correction	Total 'national contributions'	Share in total 'national contributions' (%)	
(1)	(2)	(3)=(1)+(2)	(4)	(5)	(6)	(7)	(8)	(9)=(5)+(6)+(7)+(8)	(10)	(11)=(3)+(9)
6.600.000	1.617.000.000	1.623.600.000	541.200.000	488.276.100	2.582.463.970	24.197.489	177.464.316	3.272.401.875	3,19%	4.896.001.875
400.000	48.700.000	49.100.000	16.366.667	50.703.900	258.346.033	2.420.682	18.352.242	329.822.857	0,32%	378.922.857
3.400.000	205.000.000	208.400.000	69.466.667	195.863.100	971.819.342	9.105.873	73.482.459	1.250.270.774	1,22%	1.458.670.774
3.400.000	321.500.000	324.900.000	108.300.000	289.130.700	1.716.241.222	16.081.048	112.069.456	2.133.522.426	2,08%	2.458.422.426
26.300.000	3.570.000.000	3.596.300.000	1.198.766.662	1.653.923.250	18.237.237.068	170.881.511	218.288.783	20.280.330.612	19,75%	23.876.630.612
0	21.200.000	21.200.000	7.066.667	21.597.900	102.458.098	960.025	5.994.912	131.010.935	0,13%	152.210.935
0	188.800.000	188.800.000	62.933.333	190.045.350	884.622.223	8.288.842	52.733.338	1.135.689.753	1,11%	1.324.489.753
1.400.000	206.800.000	208.200.000	69.400.000	305.838.000	1.519.248.418	14.235.241	93.051.846	1.932.373.505	1,88%	2.140.573.505
4.700.000	1.268.000.000	1.272.700.000	424.233.334	1.577.470.500	7.361.097.188	68.972.916	487.693.002	9.495.233.606	9,25%	10.767.933.606
30.900.000	1.555.200.000	1.586.100.000	528.700.000	2.797.328.100	14.195.949.972	133.014.961	965.915.065	18.092.208.098	17,62%	19.678.308.098
4.700.000	2.030.700.000	2.035.400.000	678.466.667	1.727.718.300	10.999.666.044	103.066.026	717.904.941	13.548.355.311	13,19%	15.583.755.311
0	28.100.000	28.100.000	9.366.667	26.898.000	125.204.687	1.173.158	8.528.579	161.804.424	0,16%	189.904.424
0	19.600.000	19.600.000	6.533.333	18.468.900	130.290.516	1.220.812	8.980.382	158.960.610	0,15%	178.560.610
800.000	41.500.000	42.300.000	14.100.000	35.444.400	202.702.841	1.899.310	13.953.783	254.000.334	0,25%	296.300.334
0	14.700.000	14.700.000	4.900.000	47.477.700	220.998.980	2.070.743	14.989.737	285.537.160	0,28%	300.237.160
2.000.000	104.600.000	106.600.000	35.533.334	126.576.000	683.175.478	6.401.302	47.407.944	863.560.724	0,84%	970.160.724
0	11.300.000	11.300.000	3.766.667	9.148.950	42.586.490	399.032	2.933.041	55.067.513	0,05%	66.367.513
7.300.000	1.908.300.000	1.915.600.000	638.533.333	276.721.000	4.274.354.793	- 624.989.585	50.712.043	3.976.798.251	3,87%	5.892.398.251
3.200.000	172.000.000	175.200.000	58.400.000	296.038.350	2.043.771.712	19.149.984	23.976.663	2.382.936.709	2,32%	2.558.136.709
12.800.000	357.100.000	369.900.000	123.300.000	543.004.800	2.576.425.769	24.140.912	191.435.563	3.335.007.044	3,25%	3.704.907.044
200.000	138.200.000	138.400.000	46.133.334	246.720.750	1.148.434.615	10.760.744	81.599.600	1.487.515.709	1,45%	1.625.915.709
1.000.000	110.600.000	111.600.000	37.200.000	138.123.000	871.444.032	8.165.364	67.205.154	1.084.937.550	1,06%	1.196.537.550
0	71.400.000	71.400.000	23.800.000	54.279.000	252.657.640	2.367.383	17.929.084	327.233.107	0,32%	398.633.107
1.400.000	113.500.000	114.900.000	38.300.000	64.378.800	479.759.755	4.495.312	36.948.401	585.582.268	0,57%	700.482.268
800.000	152.000.000	152.800.000	50.933.334	251.985.600	1.347.384.528	12.624.890	87.119.114	1.699.114.132	1,65%	1.851.914.132
2.600.000	489.500.000	492.100.000	164.033.334	167.499.100	2.746.004.388	- 139.156.091	33.248.018	2.807.595.415	2,73%	3.299.695.415
9.500.000	2.978.300.000	2.987.800.000	995.933.334	2.525.317.500	12.599.048.395	118.052.116	- 3.609.917.466	11.632.500.545	11,33%	14.620.300.545
123.400.000	17.743.600.000	17.867.000.000	5.955.666.667	14.125.977.050	88.573.394.197	0	0	102.699.371.247	100,00%	120.566.371.247

* Amending Budget 4/2011 (in EUR)

EN

ANNEX 2

Exceptions introduced by the European Council in December 2005 on the expenditure and income side of the budget[27]

Earmarked for Projects

- €865 million for the nuclear power plant Ignalina (Lithuania) and €375 million for the nuclear power plant Bohunice (Slovakia)
- €200 million for the peace process in Northern Ireland (United Kingdom)

Earmarked for Regions

- €879 million for five Polish Objective 2 regions (€107 per citizen)
- €140 million for a Hungarian region (Közép-Magyarország)
- €200 million for Prague
- "phasing-out" support for a Finnish Region and Madeira, which were originally "phasing-in" regions
- €100 million for the Canary Islands
- €150 million for Austrian border regions
- €75 million for Bavaria
- €50 million for Ceuta and Melilla (Spain)
- €225 million for eastern German Länder
- €136 million for the most remote regions (€35 per citizen)
- €150 million for the Swedish regions in Objective "Competitiveness and Employment"

Special Funds for Member States

- Absorption rate for Poland raised by 4%
- "phasing-in" support for Cyprus, despite never being Objective 1 region
- €2,000 million for Spain, to be distributed freely among Structural Fund Objectives
- €1,400 million for Italy (predefined distribution)
- €100 million for France (Objective: "Regional Competitiveness and Employment")
- €47 million for Estonia (€35 per citizen)
- €81 million for Lithuania (€35 per citizen)
- Additional payments from rural development:
  €1,350 million for Austria
  €460 million for Finland
  €500 million for Ireland
  €500 million for Italy
  €20 million for Luxembourg
  €100 million for France
  €820 million for Sweden
  €320 million for Portugal

[27] Source: list mainly based on "*Europe for growth: for a radical change in financing the EU*", report prepared by J. Haug, A. Lamassoure and G. Verhofstadt with the collaboration of D. Gros and P. De Grauwe, G. Ricrad-Nihoul and E. Rubio coordinated by C. Perrin, *Notre Europe*, April 2011.

Special Conditions

- 50% increased support for the former exterior borders to Romania and Bulgaria, compared to regular support for border regions
- private co-financing can be counted in for Structural Fund supported projects in new Member States (per capita GDP <85% of EU average) and eastern German Länder
- in the new Member States (<85%), VAT can be considered eligible cost for Structural Fund projects

Special Conditions in Legal Bases

- departing from "n+2" rule for new Member States (<85%) in 2007-2010
- building projects are eligible for support in the new Member States (EU10 + Romania, Bulgaria)
- 20% of funds from the first pillar (Agriculture) can be used by each country for rural development, disregarding general rules such as cofinancing
- special funds for rural development in Portugal (€320 million), without cofinancing

Special Conditions for Financing the Budget

- rate-of-call for VAT own resource contribution is reduced by 25% for Austria (from 0.3% to 0.225%)
- rate-of-call for VAT own resource contribution is reduced by 50% for Germany (from 0.3% to 0.15%)
- rate-of-call for VAT own resource contribution is reduced by 66% for Sweden and the Netherlands (from 0.3% to 0.1%)
- the Netherlands get €4,230 million (GNI own-resource). This amount is in 2004 constant prices and equals to more in current prices.
- Sweden gets €1,050 million (GNI own resources). This amount is in 2004 constant prices and equals to more in current prices.
- the rebate for the UK is kept, reduced by certain phased-in payments for the new Member States.
- Member States retain, "by way of collection costs", 25% of the amounts collected for traditional own resources.

PART 2: REFORMING THE OWN RESOURCES SYSTEM

Part 1 examined the functioning of the current financing system and explained why it should be reformed. This Part examines first the simplification of Member States' contributions through the elimination of the current VAT-based resource in parallel with the introduction of new own resources. Next, it presents a summary assessment of potential new own resources, which could fully replace the existing VAT-based own resource and reduce the scale of the GNI-based resource. The simplification of all correction mechanisms is examined in Part 3 below.

In the Budget Review, the Commission indicated that the "*introduction of a new phase in the evolution of EU financing could include three closely linked dimensions – the simplification of Member States' contributions, the introduction of one or several new own resources and the progressive phasing-out of all correction mechanisms. As changes were phased in, essential elements of the EU financing system should be retained: a stable and sufficient financing of the EU budget, respect for budgetary discipline and a mechanism to ensure a balanced budget*".

The following analysis of actual and potential own resources is underpinned by a number of criteria set out in the Budget Review and further explained in the Annex:

1. "*They should be more closely linked to the acquis and the objectives of the EU to increase the coherence and effectiveness of the entire budget in the achievement of EU policy priorities. In this respect it is important to keep in mind Article 2.2 of the Own Resources Decision*[28] *which states that "revenue deriving from any new charges introduced within the framework of a common policy shall also constitute own resources entered in the general budget of the European Union."*

2. *They should be cross-border in nature, based on a system covering the whole internal market.*

3. *They should have a harmonised base to ensure an equal application of the resource throughout the Union.*

4. *If feasible, the proceeds of a new resource should be collected directly by the EU outside national budgets.*

5. *They should be applied in an equitable and fair way, and not exacerbate the question of corrections.*

6. *The cumulative impact on particular sectors should be taken into account.*

7. *They should seek to avoid a heavy new administrative responsibility for the EU in terms of collection.*"

[28] Council decision 2007/436/EC, Euratom (7 June 2007).

1. Simplifying Member States' contributions

1.1. Context

The VAT-based own resource was established in 1970 when it was decided to replace Member State contributions by "own resources". But instead of creating a genuine own resource based on actual VAT revenues, the VAT resource is levied on a theoretical harmonised base in order to compensate for national derogations from the Union's VAT legislation, and varying tax rates. It requires complex calculations so that first VAT contributions only occurred from 1979 onwards after almost a decade of initial harmonisation process. Moreover, because of the perceived tendency of the VAT base to be relatively higher in less prosperous Member States, rules for limiting the base as a percentage of GNI ("capping") have been applied since 1988. The VAT based contribution for capped Member States is in practice based on their GNI.

The European Parliament (in the "Lamassoure resolution"[29]) remarked that the VAT-based resource changed from the intended genuine own resource with a strong direct link to European citizens to a purely statistical device for calculating a Member State contribution and therefore proposed its elimination as a first step towards introducing a new own resource.

At Member State level, Finland presented a proposal for a new own resources decision in 2004 in which it proposed to eliminate the VAT-based resource. During the preparation of a study on the own resources system, commissioned by DG Budget in 2008, a questionnaire was sent to Member States' budgetary officials asking them to assess the current system of own resources. Views about the VAT-based resource were generally negative. More than 2/3 of respondents considered this resource as either negative or very negative due to its complex administration and/or the VAT resource having become obsolete after the introduction of the GNI-based resource[30].

Within the framework of the consultation process on the budget review in 2008, a large number of respondents indicated that eliminating the VAT-based resource could contribute to a more transparent and simpler financing system, without affecting its current functioning much. This view was taken by 15 Member States. Additionally, 5 Member States seemed implicitly in favour of replacing the VAT-based by the GNI-based own resource. Only two Member States gave cautious support to maintaining the VAT-based resource or suggested eliminating it in the context of a broader reform encompassing the development of new own resources.

The Court of Auditors has criticised the VAT resource remarking that: "…*the VAT resource is levied on a "virtual" basis (harmonised VAT base which may be subsequently capped and takes into account compensation arrangements for UK) which is complex to the point of incomprehensibility; the Court recommends that consideration should be given to the*

[29] EP resolution of 29/03/2007 on the future of the European Union's own resources, P6_TA(2007)0098, § D and 22.

[30] Study on financing the European Union budget, I. Begg, H. Enderlein, J. Le Chacheux, M. Mrak, 29 April 2008, p. 61.

question whether the VAT resource still constitutes an appropriate part of the own resources system."[31]

A number of organisations and academics supported/suggested the elimination of the VAT resource and replacing it by the GNI own resource or by new genuine own resources[32].

1.2. Assessment of the VAT-based own resource

The following assessment of the VAT-based own resource can be made based on the assessment criteria set out in the Budget Review:

- Being a statistical construction, the VAT-based own resource has only a superficial link to the *acquis* and the objectives of the Union, notably in the VAT area. Even though it is related to a wide-based tax it is not visible at all to the EU citizens.
- While it relates to a VAT system defined at EU level which covers the whole internal market, the current statistical VAT-based own resource does not have an obvious cross-border dimension.
- Due to the complexity of the VAT-based own resource, there are doubts about accountability of the current scheme. According to the Court of Auditors, the current financing system is simply "*not fully auditable*"[33].
- The VAT-based own resource is not autonomous. It is transferred from Member States own revenues and, de facto, appears as a national contribution to the EU budget.
- This resource was originally perceived as inequitable and regressive. This explains in part the capping system which now benefits six Member States (see Part 1) and the progressive diminution of the uniform rate of call used for this resource. This traditional view is challenged however by a factual analysis based on recent VAT data (see Annex).
- Last, although it creates only limited additional administrative burdens, there would be some administrative savings were the VAT-based own resource to be eliminated or replaced by a simpler system. However, savings would only be obtained if there was no longer any need to calculate the uncapped VAT-base for the UK correction.

The Commission indicated in the context of the Budget Review that "*compared to the GNI-based own resource, the current VAT-based own resource has little added value. To re-create a comparable tax base, it results from a mathematical calculation rather than passing directly from the citizen to the EU. As such it contributes to the complexity and the opacity of the contributions. Ending the VAT-based resource in its current form would simplify the system of contributions in parallel with the introduction of a new own resource*". This merely confirmed a position already taken in its 2004 report on EU financing, which suggested replacing the statistical VAT-based own resource by a genuinely tax-based own resource[34].

---

[31] Response by the European Court of Auditors to the Commission's communication "Reforming the budget, Changing Europe", 9/4/2008. All the contributions made for the budget review consultation can be found on the Commission website at http://ec.europa.eu/budget/reform/issues/read_en.htm

[32] For instance, see F. Heinemann, P. Mohl and S. Osterloh, Reform Options for the EU, 2007.

[33] It should, however, be underlined that revenue is one section of the budget which has been granted unqualified discharge for many years.

[34] "Commission's Report on the operation of the own resources system", COM(2004)505, 14 July 2004.

1.3. Impact of ending the VAT-based own resource

As part of an overall agreement encompassing the introduction of one or several new own resources, the VAT-based resource could be eliminated from 1 January 2014.

The elimination of the current statistical VAT resource would have no direct impact on the existing VAT legislation (VAT Directive).

The main consequences resulting from such a reform would be as follows:

- A simplification of the contributions to the EU budget through the elimination of the most controversial and complex own resource.

- The UK correction, which is based on the UK share of the overall uncapped VAT base, could no longer be calculated on this basis. An overall reform of the correction mechanisms (Part 3) would introduce a further simplification.

- Sufficiency and stability of revenue would be guaranteed as long as there is a residual resource such as the GNI-based resource.

- There would be some administrative savings in the Commission and in the Member States. [However, such savings would only be realized if there was no longer any need to calculate the uncapped VAT base for the UK correction.]

- The direct impact of eliminating the VAT-based resource would be negligible. The elimination of the VAT resource would only very slightly modify the financing shares of Member States.

There would be transitional issues related to the structure of the resource. The data is collected in arrears and is subject first to reconciliation with payments made on forecast data and then to later correction as a result of inspection activity. There are also open items from previous years requiring resolution. It is unlikely that all the finalisation activity could be completed before five years after elimination of the resource.

2. Developing new own resources

2.1. Context

In the Budget Review adopted on 19 October 2010, the Commission indicated its intention to submit proposals on own resources as part of its overall proposals on the next Multiannual Financial Framework. New own resources could fully replace the existing VAT-based own resource and reduce the scale of the GNI-based resource.

The introduction of new own resources would mirror the progressive shift of the budget structure towards policies closer to EU citizens and aimed at delivering European public goods and genuine EU added value. It could support, and be closely linked to, the achievement of important EU or international policy objectives. In the context of economic crisis and budgetary consolidation, a new own resource could also give extra room for manoeuvre to national governments by reducing the extent of national contributions to the budget.

Considerable technical work has been undertaken by the Commission services to identify the advantages and disadvantages of a number of potential candidates as own resources, based on criteria defined in the Budget Review. The following sections summarize some of the main findings of this work, while the Annex presents a far more detailed analysis.

2.2. Financial Transaction Taxation (FTT)

2.2.1. Context

There is the potential for widely differing taxes on financial transactions, from the "broad-based FTT" affecting transactions on stocks, bonds, currencies and derivative products traded on organised markets or over-the-counter, to the simple stamp duty or transfer tax on stocks and bonds – sometimes referred to as the "narrow-based FTT".

FTT benefits from wide popular support, which could facilitate its acceptance. It is favourably perceived by a number of MEPs, including in an own resources context. The European Parliament resolution of 10 March 2010 on FTT "*calls on the Commission and the Council to assess the potential of different financial transaction tax options to contribute to the EU budget*"[35]. A number of Member States (Austria, Belgium, France, Germany…) have expressed some support for a FTT. The conclusions of the Heads of State or Government of the Euro area of 11 March 2011 indicate that "*the Heads of State or Government agree that the introduction of a financial transaction tax should be explored and developed further at the Euro area, EU and international levels*".

In the absence of significant progress at G-20 level, an EU initiative on a FTT could be a pragmatic first step towards the longer-term development of a FTT at global level.

In the Communication on Financial Sector Taxation [COM(2010)549], the Commission identified the risk of relocation which would undermine the ability to generate revenue. This requires a careful definition of the tax base and the tax rate. Introducing such a FTT on a EU-wide scale could, furthermore, reduce the possibilities of tax avoidance currently found with existing Member States' transaction taxes, would ensure a more coherent tax framework, and would eliminate one source of fragmentation of the Internal Market.

2.2.2. Main results

The financial crisis has led to debates about a possible additional tax on the financial sector. Our current analysis confirms that, under specific conditions, a FTT is technically feasible. Given the Commission's commitment to pursue the FTT at global level, and despite some positive aspects of a FAT, it is appropriate as a first step, to focus on a FTT solution at EU level to allow the EU to lead by example to create global momentum for action and to avoid interference with the forthcoming proposals on resolution framework and bank levies.

Technically, the FTT offers the advantage that using a single, harmonised tax instrument to tax the financial sector would be positive from a Single Market perspective, as it would prevent the risk of fragmentation from introduction of a patchwork of national levies.

[35] European Parliament resolution on "financial transaction taxes – making them work", P7_TA(2010)0056, adopted by 529 votes against 127 and 19 abstentions.

A FTT targeted at the trading of financial institutions and with differentiated rates would specifically answer the mandate of the European Council and the request from the European Parliament. The objectives of an FTT are threefold:

– Revenue-raising objective: a FTT would generate a new stream of public revenue, thus leading to a reduction in Member States' contributions to the EU budget. Financial institutions would contribute their fair share of the costs of the recent crisis;

– Corrective objective: overly risky activities by financial institutions should not be encouraged;

– Internal Market objective: the internal market for financial services should be preserved from fragmentation resulting from the setting up of uncoordinated national taxes.

Implementing a FTT in EU as a first step while mitigating risks identified would require defining a harmonised base, fixing low rates differentiated by products groups based on trading by financial institutions. The monitoring of the tax would rely on the implementation of foreseen regulatory changes in the financial sector (OTC derivatives, MiFID…).

The following elements could be considered for an implementation:

– The collection of the tax should, to the extent possible, be based directly on the trading books, accounting and internal control systems of financial sector institutions and/or be operated automatically through information systems or trading platforms. A number of anti-avoidance flanking measures for example based on the (forthcoming) regulatory measures would be necessary to ensure a successful implementation of the tax. In this way, risk of relocation and substitution of contracting parties could best be mitigated, although not fully avoided.

– The main taxpayers should be the financial institutions operating financial transactions, i.e. banks, investment firms, other financial institutions, also under supervision, such as insurance companies, stockbrokers, pension funds, UCITS/alternative investment funds, etc. Specific measures to cover professional activity by unregulated agents should be envisaged.

– In order to reduce the risks of tax avoidance and market relocation, the FTT should be conceived using as broad a basis as possible. The tax base should preferably be defined on the basis of trading carried out by financial institutions. The scope of financial instruments could include shares, bonds, their substitutes and related derivatives whose exact list is to be determined. Inclusion of currency trading should be further analysed with a view to compatibility with the Treaty. The taxable amount for derivatives would be the notional value everywhere it can be determined.

– In order to reduce the risk of market disruptions, a very low tax rate would be imposed on the transactions. To the extent possible, the rate structure should promote virtuous behaviours, for instance by favouring the use of regulated markets. Differentiated rates could be applied to different groups of instruments, reflecting risks of relocation and underlying valuation methods (e.g. notional for derivatives). For own resources, an indicative reference tax rate for bonds and shares of 0.1% and of 0.01% for derivative products could be suggested.

A FTT focusing on the trading of financial institutions could generate significant revenues. Although revenues projections are subject to uncertainties, recent estimates by the Commission under very conservative assumptions assume revenue of more than EUR 30 billion EUR per year for the EU-27 by 2020 for the taxation of bonds, stocks and derivatives. They could raise up to about 50 billion should currency transactions be included in the taxable base.

The cumulative impact of a FTT with the regulatory reform of the financial sector needs to be carefully considered to avoid a downward effect on main macroeconomic variables.

2.3. Financial Activities Tax

2.3.1. Context

The idea of developing a Financial Activities Tax (FAT) gained prominence following an IMF report to the G-20 on financial sector taxation. The IMF proposed a FAT levied on the sum of the profit and remuneration of financial institutions, which could also be designed to target economic rents or excessive risk taking.

2.3.2. Main results

The debate on VAT policy following the VAT green paper later this year will be a most appropriate opportunity to discuss FAT as a compensation scheme for VAT exemption on financial services.

Most recent analysis on Financial Sector Taxation shows that the FAT is most convincing in the form of the addition-method FAT applied at source. The addition-method FAT could partly address the VAT exemption of the financial sector. However, the integration with the current VAT system is difficult and the FAT could not solve the problem of irrecoverable VAT without such integration. With regard to the economic incidence of the tax, the FAT could potentially be passed on to consumers in the form of higher interest rates spreads, but it would at least partly also tax some of the rents of the sector.

The administrative implementation of the FAT could draw on existing accounting information to reconstruct a cash-flow profit. In fact, the FAT elements could be implemented using existing corporate income tax systems as a starting point.

A FAT could lead to differences in treatment between financial institutions subject to the tax and quasi-financial institutions outside its scope, i.e. the shadow banking sector. The entire financial sector includes banks, credit card companies, insurance companies, consumer finance companies, stock brokerages, management funds companies, investment funds and some government sponsored enterprises. A number of MNEs have very large financial activities without qualifying as financial institutions. For these reasons, recent proposals suggest a very wide definition of the financial sector to cover all relevant activities. In order to catch also intra-group financing and shadow-banking activities, all the enterprises conducting more than a certain threshold of financial activities would become subject to the FAT too.

The addition-method FAT could have a good fit with regulation since the tax contribution from the FAT would be correlated with the individual contributions of banks to systemic risk. It could be applied at the Member State of residence of the subsidiary (with dividends payments within a group of companies exempted) and in the Member State of location for foreign permanent establishments of non-EU financial institutions.

Owing to the high mobility of significant parts of the financial sector, the risks of fragmentation of the Internal Market, double taxation and distortion of competition, coordinated action at EU-level would appear justified - but a FAT would not need to entail full harmonisation or a centralization of revenue for the EU budget. In fact, a link between a FAT and an own resource to finance the EU budget was not made in previous Commission work and this report highlights additional difficulties which could arise from using a FAT as an own resource.

In particular, a fully harmonized FAT centrally collected at EU level is excluded.

– From a legal point of view, whereas Article 115 TFEU only provides for the "*approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market*", a centrally collected EU resource would require fully harmonized rules (under the principle of equal treatment).

– From an administrative point of view, the FAT being a new corporate tax, would require considerable administrative capacities throughout the Union to levy the tax and check tax declarations based on companies' accounts. Member State administrations would therefore need to collect and manage the tax. Furthermore, substantial administrative resources would be necessary at EU level to supervise Member State collection systems.

– Politically, a FAT would face similar obstacles towards harmonization as any form of corporate tax, as further described in section 2.8. As an own resource, a FAT could only be conceived as a system of revenue-sharing, whereby Member States would transfer a limited share of the FAT levied by their administration to the EU budget. Due to differences in the FATs between Member States, such a mechanism would likely raise opposition from a number of Member States on fairness grounds.

A FAT would likely have an impact on the financial sector, and there are substantial risks of investment relocation as well as profit-shifting. However, if properly conceived, the tax could reduce existing negative externalities, contribute to a more efficient allocation of resources throughout the economy, and the revenue collected could be usefully recycled by governments. It would, in any event, have a limited impact on GDP in the long-run.

Based on conservative assumptions on profit shifting and relocations the addition-method FAT could provide total revenue of EUR 24.6 billion for 2009 if levied at a rate of 5%, part of which could be transferred to the EU budget.

2.4. Auctioning revenue from the EU Emission Trading System

2.4.1. Context

The EU Emissions Trading System (ETS) is the cornerstone of the European Union's policy to combat climate change and the key tool for reducing industrial greenhouse gas emissions in a cost-effective manner. It has been in operation since 2005 (1st trading period). Since 1 January 2008 (2nd trading period) it applies to 30 countries (EU-27, Norway, Iceland and Liechtenstein). An amendment to the EU ETS Directive agreed in July 2008 will bring the aviation sector into the system from 2012. Important design changes agreed in the December 2008 European Council will apply from 2013 to 2020 (3rd trading period) and beyond. In particular, the significantly increased share of auctioning as a method to allocate allowances will further increase the effectiveness of the EU ETS.

Proposals on the EU ETS were not made with a view to making it an EU own resource; this option was presented for the first time in the Budget Review in October 2010. The different economic structures and energy mix lead to a significantly varying economic burden of the ETS among the Member States. The effects of an own resource linked to the ETS would thus be asymmetric and regressive at this point in time. As a consequence, the Commission did not propose any share of the allowances to be auctioned by the Commission, or any share of revenues to be allocated to the EU budget. Furthermore, political earmarking of revenues and the distribution of auction rights were a particularly sensitive issue in agreeing on such a system. It was also agreed that 50% of the auction revenues should be used for climate-related purposes.

Pursuant to the revised ETS Directive (2009/29/EC), the Commission adopted an Auctioning Regulation. The timely and solid conduct of the procurement to set up a common auction platform is of major importance for the smooth functioning of the carbon market. Failure to deliver could undermine the EU ETS.

2.4.2. Main results

The EU Emission Trading System is an EU project dealing with a cross-border issue (greenhouse gas emissions having a global impact on climate). The revenue from auctioning as well as the auctioning process is part of the *acquis*. As indicated in the Budget Review communication, possible new own resources should be more closely linked to the *acquis* and the objectives of the EU to increase the coherence and effectiveness of the entire budget in the achievement of EU policy priorities.

It would make much sense to centralise auctioning at EU level instead of having 27 national auctioneers selling the emission allowances arising from a single EU policy. A centralised collection mechanism where the Commission would sell the emission allowances and transfer the proceeds to the EU budget could reduce the total administrative burden of managing the system and make it simpler and more transparent.

Under the ETS Directive and related legal acts, emission allowances are attributed to the Member States and are to be auctioned by auctioneers appointed by them. Transforming the system into an autonomous source of revenue for the EU budget could entail risks, including the re-opening of the ETS Directive even before the auctioning system is fully functional. For this reason, a fully centralised revenue collection system does not appear suitable as a short-term option.

An alternative to a fully centralised collection of auctioning revenue by the Commission would be the development of a revenue-sharing mechanism. The Member States or their auctioneers could transfer a share of the revenues from auctioning to the EU budget, thus creating a new, CO2-based contribution alongside the existing GNI-based contribution.

A step-by-step process – first revenue sharing and then centralised auctioning at a suitable point in the future – could be conceived in order to ensure full legislative stability at the start of the implementation of the auctioning system. In order to minimise the risk of re-opening the ETS Directive, a measure establishing ETS revenue as an own resource would be wholly separate from the legislation governing the ETS. Thus, even after a (unanimous) European Council decision was taken on including ETS auctioning revenue in the own resources system, the ETS system itself would continue to be regulated in accordance with the appropriate legal base, under the ordinary legislative procedure. Depending on the variant adopted, amendments would need to be made to the Auctioning Regulation or the ETS Directive (or both).

2.5. Charge related to air transport

2.5.1. Context

Air transport is one of the EU's success stories. The liberalisation of the EU air transport market in the early 1990s was a cornerstone of EU transport policy, and has generated broad economic benefits, notably through expanded air services, greater competition and lower air fares. The EU has responded to challenges resulting from 27 separate airspaces in the Single European Sky initiatives, which includes the establishment of the €2.1 billion SESAR Joint Undertaking.

The discussion on own resources takes place in a context where several Member States have introduced an airline ticket tax or are introducing it (most recently, Germany and Austria). Mushrooming aviation taxes could have a negative impact on the proper functioning of the Internal Market and lead to tax-related distortions of competition in the air transport sector. Setting up a new own resource related to air transport could be an opportunity to ensure a more coherent taxation of the sector across the EU.

Furthermore, aviation currently benefits from a very favourable tax regime (virtually no taxation of kerosene and no VAT on air tickets) compared to, for instance, road and rail transport. The Commission adopted recently a White Paper on transport[36], which states that "*many branches of transport [including air transport] are treated favourably in terms of taxation, in comparison to the rest of the economy*". "*Generally, these arrangements provide conflicting incentives with respect to the efforts to improve the efficiency of the transport system and reduce its external costs. The Commission will examine proposals to achieve greater consistency between the various elements of transport taxation*".

At the same time, the White Paper places a strong emphasis on themes such as cohesion, competitiveness, mobility and sustainability. An aviation tax could have an adverse economic impact on Member States or regions that are particularly dependent on aviation for their

[36] COM(2011)144 of 28.3.2011.

economic development, such as island states or peripheral regions, and regions heavily dependent on inbound tourism. The European air transport industry is also facing international competitive pressures, and any tax which falls disproportionately on European airlines relative to their global competitors is likely to intensify those pressures.

Therefore, the aviation sector opposes strongly any new tax that would simply be added to existing Member States' taxes and to the Emission Trading System (which will start being applied to the aviation sector from 2012). However, Member States and the industry itself should have an interest in streamlining different national tax schemes via an EU aviation duty in order to ensure a level playing field for aviation companies, taking also into account future initiatives to be financed through the EU budget.

2.5.2. Main results

Two main options seem relevant as possible EU own resources in the air transport sector. The *departure tax* could constitute a tax levied on passengers flying from an EU airport and could vary depending on the distance and the class of travel. A *flight duty* could tax flights instead of passengers. It could take into account a distance factor and other variables, such as a measure of the performance of planes. Particular provisions could be envisaged for specific types of passengers or flights (e.g. exemptions of transit passengers or flights), respectively.

The tax could be levied using a decentralised model relying on Member State administrations, or a centralised model relying on the EU administration or Eurocontrol. In any case, the operators would pay the tax to the administration in charge. A centralised collection would lead to important economies of scale and reduced operating costs for administrations and for the operators. Relying on Eurocontrol could be an efficient approach as it would rely on an existing administration and a single billing system for companies (no additional compliance cost). However, such an approach would require the unanimous agreement of Eurocontrol's 39 member countries, but it would also offer the opportunity to involve close partners of the EU (candidate and EEA countries, etc.) in the scheme.

Setting up an aviation tax at EU level could be justified due to the cross-border dimension of aviation activity. Experiences in various Member States (The Netherlands, Denmark, Malta, Ireland, etc.) show that it is very difficult for small Member States to set up an aviation tax alone due to (the risk) of traffic displacement to neighbouring countries. Even for large Member States (Germany), flight relocations can be significant. Acting at EU level would offer the potential for important efficiency gains. A strong subsidiarity argument could thus apply for such a new own resource.

As a new own resource, an aviation duty would help to reduce the national contributions to the EU budget. Due to the cross-border nature of the tax, the national origin of the levy would be almost impossible to estimate, in particular with a centralised collection system. The revenue levied with an aviation tax could reach EUR 20 billion or more by 2020. A flight duty could potentially bring more revenue than a departure tax, or bring equal revenue with a lower duty rate, as it would tax all the flights (passenger *and* freight transport) rather than just passenger flights.

The articulation with national aviation taxes would need to be carefully examined, notably the extent to which a crediting mechanism could be introduced so as to avoid double taxation. Proper design of the tax, in particular a departure tax, could reduce the extent of flight relocations observed today. Also, any air transport tax would fall in part on non-EU nationals and companies ('tax exporting').

2.6. A new VAT resource

2.6.1. Context

The development of a common VAT system has been one of the cornerstones of the Internal Market and an important aspect of the development of an own resources system. Since 1 January 2007 the essential piece of VAT legislation in the Union has been Directive 2006/112/EC (the 'VAT Directive').

VAT represents a major source of revenue for national budgets and in many Member States it is the most important. Since the economic and financial crisis, several Member States have recently markedly increased VAT rates or are considering doing so, either as a reaction to the crisis or in the context of a longer-term shift towards indirect rather than direct taxation. The majority of Member States now have a standard rate at or above 20%.

With the publication of the Green Paper on the future of VAT on 1 December 2010, the Commission launched a debate, with all stakeholders including Member States, on the current VAT system and the possible ways forward. The introduction of a new own resource based on VAT could be underpinned by this initiative. Broadening the tax base, reducing the scope for fraud, improving the administration of the tax and reducing compliance costs in the context of a broad reform of VAT, could deliver important results and generate new revenue streams for the Member States. A fraction of the gains derived from this initiative could be attributed to the EU level, and these could be further increased as the VAT system improved its performance.

Furthermore, a genuine own resource based on VAT has been envisaged since the 1970s. The Commission considered it one of its three favoured options in 2004. The arguments in favour were and are its potential visibility for EU citizens, its buoyancy and stability, as well as the fact that VAT is already collected throughout the EU. However, there has not been a detailed proposal regarding a new VAT resource in the past two decades. Assessing this candidate with regard to the criteria set out in the Budget Review thus requires its basic features first to be defined.

2.6.2. Main results

Two main approaches have been assessed for the development of a new VAT resource to replace the current statistical VAT-based own resource: a parallel system to that of the Member States and a revenue transfer mechanism.

For both approaches, a narrow base has been retained in order to overcome the likely reluctance to apply a new VAT resource on goods and services subject to zero or reduced rates at national level and the hurdle of the high degree of harmonisation required for the functioning of a broad based VAT.

The new VAT resource would therefore be a single EU rate applied on all the goods and services currently subject to the standard rate in every EU Member States, i.e. the tax base would correspond to the smallest common denominator of national VAT systems. This means that a supply subject to national VAT at the standard rate in a Member State would be subject to the new VAT resource rate unless the same supply is subject to a reduced rate or an exemption in another Member State.

A new VAT resource alongside Member States' VAT would pose serious technical implementation problems and has therefore been discarded. Indeed, given that the scope and the rules of deduction of national VAT and the new VAT resource would be different and that no compensation between those taxes would be possible, the taxable persons would need to identify in their accounts each tax separately for each purchase and sale in order to complete parallel declarations determining their net position for each VAT.

Moreover, an original complete legal framework covering the rules on the scope and exemptions of the new tax, the deductions, the obligations of taxable persons and the role of the national tax authorities, etc. would need to be created to ensure the proper collection and control of the new VAT resource. Tax administrations and about 35 million taxpayers, including the smallest retailers, would therefore in effect have had to deal with a double VAT system in order to allow the EU to collect the new resource.

The simplest solution with similar results in terms of revenue but with limited impact on businesses and less impact on national tax administrations has been chosen. It would require the latter to regularly transfer a share, corresponding to the EU rate, of the VAT receipts collected and stemming from transactions subject to the standard rate.

On the basis of the VAT returns, the tax administrations would apportion the VAT receipts between the VAT stemming from the standard rate and the reduced rates and would then exclude from the former, on the basis of national accounts data, consumption data or other sources, the VAT stemming from the few transactions not subject to the new VAT resource.

Unlike the existing VAT-based own resource, the revenue stream would not be capped and would not be the result of the current complex statistical calculations and adjustments to obtain a purely theoretical VAT base. It would result from the actual new VAT resource paid by all the European final consumers and then collected by the national tax authorities.

Moreover, this system would closely link EU policies for VAT with EU budget policies. The revenue would be increased when the national VAT bases are broadened and the scope of zero or reduced rates diminished by the Member States making use of the same options or derogations or by new European VAT rules imposing such moves.

The application of a 1.0% rate on supplies of goods and services, intra-Community acquisitions of goods and importation of goods subject to a standard rate of VAT in every Member State pursuant to the VAT Directive would lead to revenue estimates of EUR 20.9 billion to 50.4 billion (2009 data). The revenue estimates are dependent on the degree of harmonization of VAT rules in the EU towards a broader based tax with a single rate: the first estimate assumes that there is no further harmonization of the VAT bases and of the scope of the standard rate in the EU[37], while the second estimate assumes full harmonization with all the transactions being subject to the standard rate.

[37] The total harmonised VAT base in the EU (EU-27, 2009) has been decreased by extrapolating data for Ireland, where only 41.4% of the non exempted base is subject to the standard VAT rate (2006).

2.7. Energy Tax

2.7.1. Context

Several key aspects of energy taxation are already governed at EU level under the Energy Taxation Directive (ETD - Council Directive 2003/96/EC). In order to align the ETD to the new policy framework resulting from the climate and energy package and the development of an EU emission trading system, a Commission proposal to amend the ETD has recently been adopted[38].

Although the ETD was not prepared for the purpose of introducing new own resources, it nevertheless creates suitable conditions by harmonising tax bases and establishing minimum rates. In 2004, the Commission suggested that an EU levy be imposed on motor fuel used for road transport. The Commission concluded that "*EU rates below half of the minimum rates would be enough to finance half of the current EU budget*".

Since 2004, little progress has been achieved towards the approximation of excise duties on diesel used for professional transport. However, the rapidly evolving political context and the in-depth revision of the Directive provide a new framework for discussion of an EU Energy Tax. The modified system of energy taxation, which would include a CO_2 tax plus an energy tax, could open new opportunities and entail additional issues for setting up a new own resource. The scope of the own resource could be different than what was envisaged previously and include part or all sectors covered by the ETD.
Furthermore, a potential link to the energy infrastructure needs, for which future EU budget support will be needed, could also be envisaged. It should be recalled in this context that infrastructure funding at the EU level, whether coming from a well identified energy tax or from another budgetary resource of the EU, remains indispensable as recognised at the European Council of 4th February 2011.

2.7.2. Main results

Considering the close link between energy consumption and CO2 emissions and the important developments of the energy taxation framework at EU level, two main variants of this candidate have been identified.

- The EU Energy Levy would consist of applying a single EU rate to the quantities of energy products released for consumption in each Member State, possibly based on the energy content of the products.

- The EU CO2 Levy would consist of attributing to the EU budget (part of) the revenue from applying the minimum rate of CO2-related taxation defined in the revised ETD. In addition, it could be envisaged to add (part of) the proceeds from auctioning emissions allowances under the ETS.

The EU Energy levy and the EU CO2 Levy would be closely related to the *acquis*, involve an important cross-border dimension and require a harmonised approach at EU level. To ensure a consistent approach regarding CO2 emissions, the EU CO2 Levy should preferably be considered together with a resource based on the auctioning of emission allowances under the EU ETS.

[38] COM(2011)169 of 13.4.2011.

The EU Energy levy and the EU CO2 Levy could be collected either by the Member States or by the EU administration. Member States' collection would involve an annual computation of the levy and the transfer of corresponding revenue from the Member States to the EU budget. Centralised EU collection would involve supplementary operating costs, but it would give more visibility and more autonomy to the EU resource.

Both variants could bring substantial resources to the budget. However, as long as the revenues were collected by the Member States as part of a revenue-sharing mechanism, it could be seen as a contribution to be minimised. Differences between Member States would be observed in line with differences in the energy- or CO2-intensity of their economies.

2.8. EU Corporate Income Tax (EUCIT)

2.8.1. Context

The existence of 27 largely uncoordinated corporate income-tax systems in the EU is a source of considerable problems. The Commission has recently proposed its Common Consolidated Corporate Tax Base (CCCTB) initiative.

2.8.2. Main results

While the CCCTB proposal constitutes a comprehensive and ambitious approach to solving, with one single instrument, the existing corporate income taxation problems within the EU, EUCIT would go beyond this and impose a harmonised corporate tax base to all business being involved or not in cross-border activities. This entails questions concerning respecting the subsidiarity principle and the appropriate legal base on which to act. It might, however, contribute to a more efficient allocation of investment in the Internal Market.

However, in practice, EUCIT is certain to be confronted by considerable opposition, not only from the corporate world, which would oppose any compulsory harmonisation of both the tax base and the tax rates in the EU, but also from many Member States which wish to protect their sovereignty in this area.

Moreover, setting up such a system would generate considerable administrative issues and entail the re-organisation of national tax systems far beyond corporate taxation because of the close interaction of corporate income taxation with personal taxation. In any event, although the EUCIT would need to be levied by national administrations, and substantial control systems would also need to be set up at EU level.

There would be differing impact on specific sectors; the most expensive aspect would be transforming transparent companies in Germany, Luxemburg and Austria into corporate tax payers. The current network of bilateral conventions aimed at eliminating double taxation would also need to be revised. In addition, adjusting to the new system might prove very costly for companies, notably the 80% of EU companies active only in one Member State.

Lastly, the prospects for adoption by the Council of the CCCTB could be materially damaged if the Commission were to propose a CIT making use of the CCCTB.

With corporate income-tax revenues representing between 2% and 3% of GDP in the EU, the revenues from a EUCIT could easily reach billions of EUR per year. Given that the average statutory corporate income tax rate currently amounts to around 23%, a back-of-the-envelope calculation suggests that, assuming a comparable tax base size a EUCIT rate of less than 2% should be sufficient to consistently raise EUR 15 billion in revenue, even though CIT revenues are one of the most fluctuating tax revenue sources in the economic cycle. Besides, autonomous tax collection is virtually impossible (millions of tax payers and annual declarations).

Simulations for the distributional effects of CCCTB on the base show that the formula with employee costs, assets and sales by destination equally weighted leads to an increase in the tax base (for industrial and financial groups combined) mostly in those Member States in Central and Eastern Europe, as well as in Germany, Spain, France, Greece and Italy.

PART 3: SIMPLIFYING THE EXISTING CORRECTION MECHANISMS

The current financing system is made rather complex by numerous corrections mechanisms. The most important of these mechanisms, which were described in detail in Part 1, are linked to revenues. The correction mechanisms are either temporary and will end at the end of 2013, or relate to the UK correction (the UK correction itself and the corrections on this correction granted to Germany, the Netherlands, Austria and Sweden). The following analysis therefore logically focuses on the UK correction and possibilities for its reform, bearing in mind that a change of this correction has an immediate impact on the related corrections.

1. An evolving context

1.1. Origin of the correction mechanisms: a major net contributor with low relative prosperity

At the time of accession, the UK had a small agricultural sector with a large proportion of farm produce imported from outside the Community. As a result, very little of the Community's agricultural spending, which represented at the time the vast majority of EU expenditure, was oriented towards the UK economy. On the other hand, the UK contributed a relatively large amount to the financing of the Community budget mainly because its VAT base at the time represented a higher percentage of its GNP when compared to other Member States. Furthermore, the UK was not as prosperous as the other net contributors to the budget. This structural imbalance became a major issue underlying the 1975 referendum on the question of the UK's continued membership of the Community.

After unsuccessful attempts at introducing a corrective mechanism, an agreement was reached at the Fontainebleau European Council in June 1984**,** which concluded that "*expenditure policy is ultimately the essential means of resolving the question of budgetary imbalances*". At the same time, the phrase "*any member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time*" opened the door to creating correction mechanisms. The UK correction was created by the Own Resources Decision of 7 May 1985. Since then there have been changes to the UK correction including corrections on its financing, initially only for Germany, and then also for the Netherlands, Austria and Sweden.

1.2. From 1985 to 2005: a new context

Those elements which justified the creation of the UK correction had evolved significantly by 2005, when the current financial framework was agreed. This can be seen in Table 5 below:

- Agricultural expenditure (first and second pillar) represented 50% of the 2005 budget vs. 69% in 1984;
- VAT-based contributions (traditionally viewed as unfavourable to the UK in comparison with GNI-based contributions) represented 16% of the 2005 budget vs. 57% in 1984;
- The UK was the poorest of the net contributors in 1984 (93% of EU10 average GNI pc PPS versus Germany at 127% and France at 102%). In 2005, the UK situation at 117% of the EU-25 average was better than both Germany (112%) and France (106%). In other words, while the UK was one of the poorest Member States when it acceded, by 2005 it

had become one of the richest. And while its prosperity level had been far below that of Germany and France, it was at higher level than these countries in 2005.

Furthermore, the cost of enlargement (EU-12) was a new element fundamentally changing the composition of EU expenditure, which needed to be shared fairly among all Member States.

This led the Commission to conclude that there was no longer any objective reason to treat the UK differently from the other major net contributors. Based on the principle of equal treatment, the Commission therefore presented, in the 2004 Own Resources Report, a proposal to introduce a generalised correction mechanism[39]. Although this proposal was not adopted, a limited reform of the correction system was nonetheless agreed.

In December 2005, political agreement was reached to exclude an important part of the expenditure in the 12 new Member States from the calculation of the UK correction. This resulted in a reduction of the UK correction. Nevertheless the amount of the UK correction remains substantial – more than EUR 3.5 billion per year –, and higher than what it was until the mid-1990s (see Annex 1).

Table 5: Evolution of key parameters (1984-2011)

	1984	**2005**	**2010**
Share of CAP in budget (% of total)	69%	50%	42%
VAT-based contribution (% of total)	57%	16%	10%
UK prosperity (GNI per capita PPS)	93% of EU-10	117% of EU-25	115.5% of EU-27

Source: European Commission, DG Budget and DG ESTAT

New corrections were also introduced in the current (June 2007) Own Resources Decision. Unlike the UK correction, they are temporary and will automatically expire in 2013. This is true both of the differentiated call-up rates for the VAT-based contribution which benefit Germany, the Netherlands, Austria and Sweden and the gross reductions of the GNI contributions for the Netherlands and Sweden (see section 2 of Part 1). Their temporary nature was an important political decision taken in December 2005. However neither the UK correction nor the rebates on the rebate (Germany, the Netherlands, Austria and Sweden pay one quarter of their normal share) have expiration dates.

1.3. Situation today: need for a new approach

Major trends observed in 2005 have been confirmed in recent years and are expected to continue in the future.

– CAP spending as a proportion of the total budget has continued decreasing as a share in the EU budget and the VAT-based contribution is now a marginal element in the

[39] See COM(2004)505 Vol. 1 and 2 of 14.7.2004.

financing system. Furthermore, the relative prosperity of the main beneficiaries of correction mechanisms (Germany, The Netherlands, Austria, Sweden and the UK) remains largely above the EU average following the enlargements of the Union in 2004 and 2007 (see Tables 5 and 6).

– Beyond 2013, it is expected that the relative weight of the agricultural sector in the total EU budget will continue to decline as CAP embraces the objectives of the EU 2020 agenda. Furthermore it is proposed to fully eliminate the current statistical VAT-based own resource. With the cost of enlargement reaching its cruising speed, an increasing part of transfers organized through the EU budget will benefit the 12 Member States which acceded the Union in 2004 and 2007, a policy that was actively supported by the major net contributors to the EU budget.

However, as a result of the discrepancy between the marked evolution in the factors that justified the UK correction when it was introduced and the limited reform of this mechanism since then, the UK was the smallest net contributor to the EU budget in percentage of GNI over 2007-2010 despite having a relatively high level of prosperity (see Table 6). On the basis of the Fontainebleau agreement, which was consistently applied in the various own resources Decisions, the existing correction mechanism granted to the UK generates a budgetary situation which is considered as unfair by a very large majority of the Member States. It therefore appears difficult to justify the mere continuation of the current specific treatment of which this country benefits in the context of EU financing.

At the same time, it must also be acknowledged that, without a correction mechanism, the UK would have been one of the largest net contributor (in % of GNI) to the EU budget. Notwithstanding the enormous gains derived from the EU and successive enlargements for the UK economy, this fact can explain the reluctance towards abrupt changes to the existing correction mechanism in the UK. Consideration should therefore be given to the replacement of a mechanism that served its purpose well for many years but which has now shown its limits, by a more suitable mechanism.

Table 6: Prosperity and net contributions

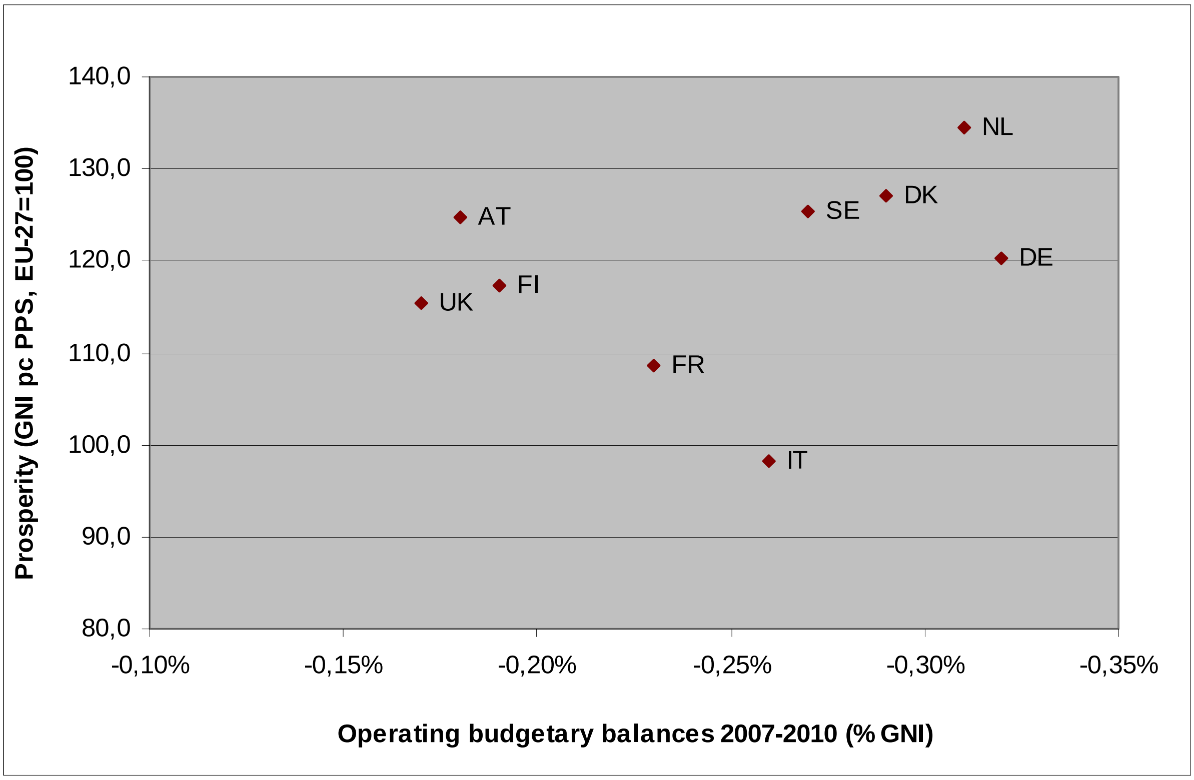
	Operating budgetary balances average 2007-2010 (% GNI)	**Prosperity 2010 (GNI pc PPS, EU-27=100)**
Denmark	-0.29%	127.0
Germany	-0.32%	120.2
France	-0.23%	108.7
Italy	-0.26%	98.2
Netherlands	-0.31%	134.4
Austria	-0.18%	124.7
Finland	-0.19%	117.3
Sweden	-0.27%	125.3
United Kingdom	-0.17%	115.5

Source: European Commission, DG Budget

Table 6 illustrates that the existing net balances are very small in percentage of GNI, in particular from a historical perspective these can certainly be considered as being rather low.

More generally, Table 6 also illustrates that countries with equivalent levels of prosperity have significantly different levels of operating net balances to the EU budget[40]. This appears particularly clearly when the corresponding data is presented graphically (see Graph 2). **This suggests** that if the objective of the correction mechanisms was to achieve an equalization of net balances for countries with similar level of prosperity, it apparently failed to reach that goal.

Graph 2: Operating net balances and relative prosperity



More importantly, an accounting approach focused on net balances is certain to generate dissatisfaction for the Member States. An accounting system is a zero-sum game where the gain of one player always comes at the expense of another (see Box 1). This comes in contradiction with a fundamental feature of the European political project, which aims at creating a positive sum-game, notably through the realization of common projects with the EU budget. Instead of opposing Member States, the European project aims at uniting them, which some proponents of a *juste retour* concept sometimes forget.

In the context of a reform of EU financing, any new correction mechanism will need to be carefully justified, not only by way of debatable accounting measurements (see below), but in view of the overall balance of benefits brought by the EU budget and policies, and reflect the relative prosperity of the Member States concerned.

---

[40] Belgium and Luxembourg are not included in the table. Their respective budgetary balances vary a lot depending on whether administrative expenditures are taken into account. When these expenditures are not taken into account, as is the case for operating budgetary balances, these two countries appear as net contributors at levels comparable to Denmark, Germany and the Netherlands. However, when administrative expenditures are included, as is the case of net balances calculations for UK correction purposes, these countries appear as net beneficiaries of the EU budget.

2. Key principles to assess correction mechanisms

2.1. Back to the basics: the Fontainebleau principle

The Fontainebleau principle constitutes the political foundation of **the correction mechanisms (see Part 1, section 2). This principle does not *impose* the use of correction mechanisms at any time: it just recognizes that, under a vaguely set of defined circumstances, a correction may be used.**

Elements subject to interpretation include the notion of "budgetary burden", which may relate to gross national contributions, net balances (see Box 1), or any other notion of excessiveness in relation to the budget; "relative prosperity", which may relate to any notion of macroeconomic prosperity (GDP, GNI…) measured in Euros or in purchasing power parities and compared in percentages or on a per-capita basis; the "appropriate time" is equally a matter of interpretation.

Box 1: Budgetary balances revisited

Although net balance calculations have been used for many years, this notion is subject to considerable criticism.

As an accounting exercise aiming at attributing to specific countries expenditure and contributions to the EU budget, net balance calculations ignore any notion of the added value of EU policies related to the budget. The fact that expenditures at EU level may in some cases lead to considerable economies of scale and avoid duplication of Member States expenditure is simply ignored.

Net balance calculations are always a zero-sum game. This means that the accounting advantage of one Member State comes, by definition, at the expense of another Member State. Hence, net balances, by their nature, create and reinforce antagonisms in budgetary discussions – and beyond.

The conventions which determine net balance calculations are arbitrary – revenue and expenditure allocation assumptions are highly questionable. Examples include:

- European programmes such as Erasmus, where EU assistance benefits both the Member State which students leave to study abroad and the Member State of destination;

- Research and innovation, where cross-border spill-overs are enormous and investments in one project may have EU-wide implications;

- Cohesion policy, where a significant part of projects financed by EU funds benefit companies located in other Member States, in particular "net contributors" to the EU budget;

- Agricultural policy, where important direct aids are paid in each Member State to large agri-food companies located in other Member States or in third countries;

- Home affairs, where transfers paid to one Member State are often of direct interest to its neighbours;

- Administrative expenditure to the benefit of the entire Union, which are "allocated" to those Member States where institutions are located (mainly Belgium and Luxembourg).

In a nutshell, *"it is difficult to break down expenditure by beneficiary Member State except in very special cases*".[41]

The arguments set out in Box 1 suggest that the design of a correction mechanism should not be based on an explicit calculation of net balances as is currently the case for the UK correction. Whereas accounting calculations may provide useful indicative measures of financial flows, they do not constitute a sound basis to build a correction mechanism. And they are certainly not the only parameter that should be looked at.

Moreover, a formula-based correction mechanism using net balances calculations is fundamentally inefficient. It reduces the incentive for the country concerned to spend money allocated in the context of EU policies. For instance, with the current UK correction, money not spent increases the net contribution of the UK, with a subsequent correction for 2/3 of the amount. Conversely, money rightly allocated to the UK is reduced mechanically via the UK correction. This can have important consequences, for instance when EU solidarity fund is spent in favour of the UK (e.g. to alleviate the dramatic effects of floods in some recent years): 2/3 of this spending is cancelled out by a reduction of the UK correction.

Whatever system is conceived for the future, the concept on which the current UK correction is based will need to be fundamentally revised in the light of past experience.

2.2. Four guiding principles to design a new system

This report therefore proposes four guiding **principles for defining and assessing possible correction mechanisms for the future:**

- **Fairness: In line with the Fontainebleau principle, any correction should compensate for** a budgetary burden which is excessive in relation to the relative prosperity of a Member State. A correction should therefore ensure a level playing field for Member States in similar positions, taking into account all relevant elements. At the same time **all Member States should contribute to the financing of a correction.**

- **Transparency and simplicity: A correction mechanism needs to be easy to understand. The benefit for the recipient(s) and the financing of the correction need to be clearly identifiable and unequivocal, thus facilitating parliamentary oversight.**

- **Limitation in time: A correction mechanism is a response to a situation prevailing at**

[41] See Le Cacheux, J. (2005), "The poisonous budget rebate debate", *Notre Europe*, Studies & Research, N°41.

a specific time. In line with the Fontainebleau principle, it is closely related to the structure of expenditure and it should therefore not apply beyond the duration of a Financial Framework.

- **No reduction in incentives for implementation: Member States profiting from a correction should not become reluctant to implement EU-programmes in their country. As was explained above this problem currently exists with the UK-correction. In practice, a correction should be determined *ex ante*.**

3. Alternative correction mechanisms

Based on the above principles, this section looks at the design of various alternative mechanisms.

There are two main approaches (with some variants): a lump sump system and a generalised correction mechanism.

- In a lump sum system, all existing corrections would be transformed into a lump sum gross reduction on GNI payments: the UK correction, the "rebates on the rebate" for Germany, the Netherlands, Austria and Sweden would be eliminated as well as the hidden correction consisting in a retention of 25% of traditional own resources as "collection costs". The use of GNI reductions would apply strictly to those Member States for which a perceived excessive budgetary burden can be demonstrated. It would be an *ad hoc* solution comparable with the current gross reductions for the Netherlands and Sweden agreed as a part of the package in December 2005. Such a system would be able to address directly any future problems, while simplifying the current system considerably.

- In a generalised correction mechanism (GCM), the UK correction would be replaced by the GCM and no other corrections would be applied. The GCM (limited in scope to certain categories of expenditure or not) with no restriction on the amount of corrections and 100% refund rate (as compared to currently only 66% for the UK correction) would have a considerable impact on accounting net balances. However, compared to the simple and transparent approach of granting lump sums there seems to be no advantage to this approach (see below).

Benchmarking against the key principles set out for reforming the correction mechanism, the simple and transparent approach of granting lump sums seems preferable to the systematic but complex GCM:

- Fairness: both approaches have the potential to tackle excessive budgetary burdens. However, GCM only does so with regard to one parameter, namely the (debatable) measure of net balances in percentage of GNI, whereas the lump sum system lends itself to tailor-made solutions taking into account all relevant parameters related to potential budgetary imbalances and relative prosperity.

- Transparency and simplicity: in general, gross reductions implemented via GNI lump sum payments are simple and transparent with corresponding amounts precisely known in advance. The GCM is quite complex and it is as opaque as the current UK correction mechanism.

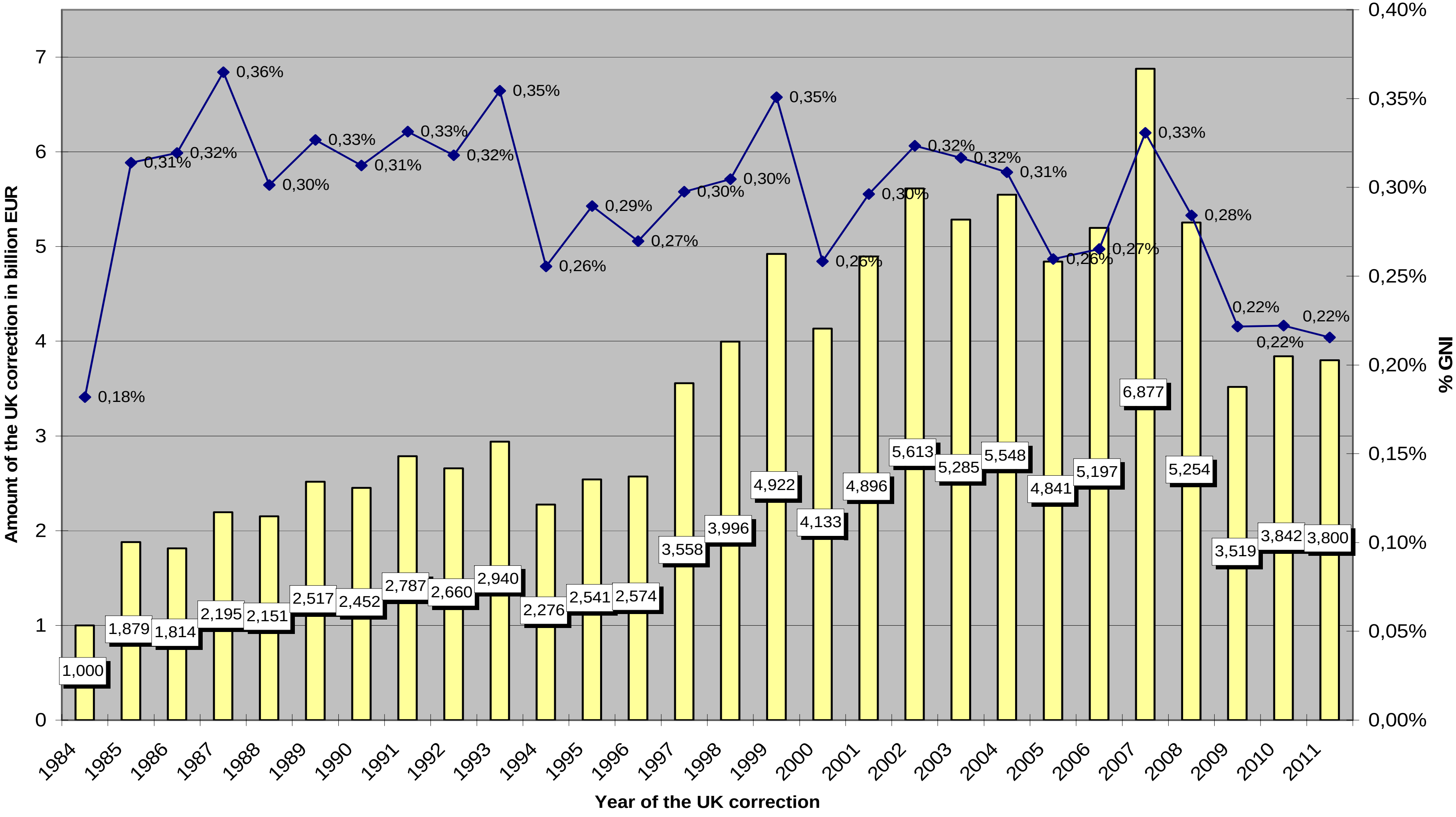
- Limited in time: experience of past negotiations suggests that it is easier to limit the duration of *ad hoc* corrections than systematic correction mechanisms; once a formula-based system is installed it is likely to persist.

- No reduction in incentives for implementation: the GCM with 100% refund rate could be regarded as even worse in this respect than the UK correction mechanism. Those national governments paying would have lower incentives to implement additional EU expenditure programs (or certain programmes with a limited GCM). Lump sum payments do not have any negative impact on incentives to implement EU programmes because they are agreed ex-ante and do not depend on ex-post budget executions.

Table 7: assessment of alternative correction mechanisms

Main relevant assessment criteria	**Current UK correction**	**GNI lump sums**	**GCM**
Fairness	-	+	+
Transparency and simplicity	--	++	-
Limited in time	--	++	-
No negative impact on incentives to implement EU budget	-	++	--

ANNEX 1. THE AMOUNTS OF THE UK CORRECTION OVER 1984-2011



Note: The amounts of the UK correction for 2008-2011 are provisional.