EUROPEAN PARLIAMENT

Briefing

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'Monti' Group's first assessment of EU own resources

SUMMARY

The 'own resources' system, which ensures the financing of EU policies, has advantages such as reliability in providing the necessary resources, but has also attracted a number of criticisms, not least for its complexity and lack of real financial autonomy. The European Parliament (EP), which has little say in the design of the system, has long pushed for its reform. The aim is not to increase the size of the EU budget, but to focus it on issues of European common interest and to tap its full economic potential. However, the relevant decision-making process (unanimity and ratification by all Member States) represents a significant obstacle to reform.

As part of the deal on the EU's Multiannual Financial Framework (MFF) for 2014-20, the EP, the Council and the European Commission have created a high-level group (HLG) on own resources. For the first time, an inter-institutional forum is tasked with a thorough review of the system. In December 2014, the HLG, chaired by Mario Monti, presented its first assessment report, which looks at the key features of the system and at recent reform attempts. In addition, the HLG sketches out the methodological approach that will guide its work, noting that the viability of reform recommendations will depend not only on the economic soundness of the proposals but also on careful consideration of the institutional and political aspects of the reform process.

In 2016, the HLG will present the final outcome of its analysis, which national parliaments are expected to assess. The same year, in parallel with the planned review of the 2014-20 MFF, the Commission will examine whether the outcome of the work justifies new initiatives in the field of own resources, with possible reform of the financing of the EU budget for the period covered by the next MFF.

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Financing of the EU budget: advantages and criticism

The 'own resources' system ensures the financing of EU policies. The current system (see box) has reliably provided **sufficient and stable resources**, which is crucial given that the EU budget cannot run a deficit. Many stakeholders consider that own resources have achieved this result **effectively** from an administrative standpoint.

However, the system is often criticised for a series of shortcomings, for example by the European Parliament, the European Commission, and the European Court of Auditors, as well as in a number of studies. Weaknesses are said to include **complexity** and **opacity**, to which a series of exceptions and so-called correction mechanisms (such as the UK rebate) add. Since most EU revenue is currently perceived as stemming from national contributions, some stakeholders say that the system lacks real financial autonomy and is therefore **against the spirit of the Treaties**; this in turn can focus attention on so-called 'budgetary balances',[1] which may reduce the effectiveness of expenditure, potentially contributing to rigidity in the structure of spending and favouring instruments with geographically pre-allocated funds rather than those with higher EU added value. Consequently, changes to the own resources system are often considered a crucial part of reforming the EU budget, including its spending.

The European Parliament's push for reform

The EP, which has limited influence on the revenue side of the EU budget, has long pushed for an overhaul of the own resources system, as shown, for example, by **two important resolutions adopted in 1999 and 2007**.[2] Parliament stresses that the objective of reform is not to increase the level of EU spending, but to improve the way it is financed.

A significant obstacle to reform of the system is the relevant **decision-making mechanism, which requires unanimity and ratification by all Member States**. The EP is only consulted. The most recent reform proposal was put forward by the European Commission in 2011 as part of the package of proposals for the EU's 2014-20 Multiannual Financial Framework (MFF). The goal was to reshape the system and to streamline its functioning by addressing some of the weaknesses identified by stakeholders. In particular, the **introduction of new genuine own resources** was meant to reduce the role currently played by so-called national contributions.

As was the case with previous proposals, negotiations did not lead to significant modifications, with Member States eventually agreeing to only limited changes to the system. However, one of the EP's conditions for consenting to the 2014-20 MFF was **the establishment of a high-level group to carry out a general review of the financing system** of the EU. This could potentially pave the way for new reform proposals from the European Commission for the period covered by the next MFF.

The high-level group on own resources

Composition

In a joint declaration accompanying the agreed 2014-20 MFF, the European Parliament, the Council and the European Commission decided to create a high-level group (HLG) on own resources. In February 2014, the three institutions officially launched it, establishing **for the first time an inter-institutional group** tasked with a thorough review of the own resources system and involving the EP.

The Parliament, the Council and the Commission appointed three members of the group each, while jointly choosing **Mario Monti**, President of Bocconi University, former Prime Minister of Italy and former Commissioner, as its chair. On 3 April 2014, the first meeting of the HLG took place in Brussels, with three subsequent meetings during the year. The composition of the HLG was partially modified following the entry into office of the new European Commission, with the replacement of the members of the HLG appointed by the previous Commission. In addition to the chair, the current nine members are:

- **Ivailo Kalfin** (former MEP, Deputy Prime-Minister of Bulgaria and Minister of Labour and Social Policy), **Alain Lamassoure** (French MEP in the EPP group) and **Guy Verhofstadt** (Belgian MEP, chair of the ALDE group), appointed by the EP;
- **Daniel Dăianu** (former MEP and Finance Minister of Romania), **Clemens Fuest** (President of the Centre for European Economic Research ZEW in Germany) and **Ingrida Šimonytė** (former Minister of Finance of Lithuania), appointed by the Council; and
- **Kristalina Georgieva** (Vice-President of the Commission in charge of budget and human resources), **Pierre Moscovici** (Commissioner for economic and financial affairs, taxation and customs) and **Frans Timmermans** (First Vice-President of the Commission responsible for better regulation, inter-institutional relations, rule of law and Charter of Fundamental Rights).

Mandate

The joint declaration of the three EU institutions defines the mandate of the HLG, detailing the **four guiding principles** for the review of the own resources system: **1) simplicity; 2) transparency; 3) equity; and 4) democratic accountability**. The HLG is meant to drive further discussion on the future of the own resources system, with its **final report of 2016** potentially leading to new reform proposals from the European Commission.

The work of the group is to be based on both existing and new analyses provided by the three institutions and national parliaments, and to draw on relevant expertise. The creation of the HLG has already **revived the debate** on the future of EU finances, as shown for example by a workshop hosted by the German Federal Ministry of Finance in July 2014.[3] The HLG delivered its first assessment of the system before the end of 2014, as planned in its mandate.

The first assessment report

On 17 December 2014, Mario Monti presented the first assessment report of the HLG to the Presidents of the three institutions that created the group. The document **recaps the key features** of the current system (see box), singles out those that are perceived by stakeholders as requiring modifications, and analyses the most recent (and, by and large, unsuccessful) reform proposals. In addition, the group sketches out some elements of the **methodological approach** that will guide its work and be set out in more detail in the months to come. Members of the group underline that they take part in the deliberations as individuals rather than as representatives of the institutions that appointed them.

An intermediary and tentative conclusion is that the financing system of the EU has not experienced any major modifications over the last 25 years, proving difficult to change. However, the group notes that keeping reform of the own resources system on the

political agenda shows that European stakeholders are aware that progress in this area could help **tap the full economic potential of the EU budget** and **focus on issues of European common interest**. A precondition for any progress, the report adds, is that all those involved in any overhaul of the system acknowledge that, from both an economic and a political perspective, the EU budget has positive spill-over effects, thus representing much more than a zero-sum game with net beneficiaries and net contributors.[4]

The own resources system

The first assessment report of the HLG defines own resources as 'revenue accruing irrevocably to the EU in order to finance its budget without being conditional [on] a decision by national authorities'. Under Article 311 of the Treaty on the Functioning of the European Union (TFEU), the Council determines the provisions governing the own resources system by way of a special legislative procedure, which requires unanimity and ratification by all Member States. The EP is only consulted. Council Decision (EC, Euratom) 2007/436 is the legal basis currently in force, pending ratification of Decision (EU, Euratom) 2014/335, which will apply retroactively from 1 January 2014. Rules implementing Decision 2007/436 are set out in Council Regulation (EC, Euratom) 1150/2000, as amended most recently in 2009.[5]

The amount of own resources allocated to the EU is capped at 1.23% of the Union's gross national income (GNI). In 2013, total EU revenue amounted to €149.5 billion, which came mainly from three categories of **own resources**: 9.38% from *traditional own resources,* mostly customs duties; 10.28% from *a resource based on value added tax (VAT)*; and 73.71% from *a resource related to Member States' GNI*, which plays the budget-balancing role, by financing that part of EU expenditure not covered by the other resources and revenue.

In addition, there is a series of **correction mechanisms**, of which the biggest and best known is the *de facto* permanent UK rebate: EU countries benefiting from a correction mechanism enjoy a reduction in their contribution, which is financed by the other Member States. In addition to the UK, the countries granted one or more (temporary and/or permanent) correction mechanisms under the new Decision are Austria, Denmark, Germany, the Netherlands and Sweden. In EU financial reporting, the sum of the VAT and GNI-based resources and related correction mechanisms is labelled **national contribution**.

Other revenue, which is not classified as own resources, accounted for 6.63% of total EU revenue in 2013. This included taxes on EU staff salaries, fines on companies for breaching competition law, and contributions from non-EU countries to certain programmes.

Perceived shortcomings of the system

While observing that some stakeholders do not see any major reasons to change the current way of financing the EU budget, the assessment report recapitulates the main shortcomings of the system perceived by others. These include **complexity** and **lack of transparency**, notably in relation to the wide range of **correction mechanisms** and to the configuration of the **current VAT-based resource**. Another section of the report says that one effect of the correction mechanisms and their financing is that the current system of national contributions is seen as **regressive** overall, meaning that less affluent[6] Member States do not contribute proportionally less to the EU budget.[7]

The **key role gained over time by the GNI- and VAT-based resources** (providing more than 80% of total revenue in 2013), which are perceived as national contributions rather than as genuine own resources of the EU, is said to have sharpened the difference in perspectives between countries classified as net beneficiaries of, or net contributors to, the EU budget, with a potential negative impact on the focus and effectiveness of EU spending. The GNI and VAT resources are both based on statistical calculations that had

never been questioned until recently, when higher-than-usual annual adjustments of the relevant statistical aggregates brought their technical aspects into the spotlight.[8]

In addition, according to the report, some limits of the EU's financing system have been exposed by the economic crisis and the fiscal difficulties that this has triggered at national level. The text draws a link between the above-mentioned criticisms of resources perceived as national contributions and the **ever-increasing year-end backlog of payments** afflicting the EU budget in recent years,[9] given that in many national budgets the contribution to the EU budget appears as an item of expenditure.

Last, but not least, attention is drawn to the **very complex decision-making mechanism** requiring unanimity and ratification by all Member States to change the rules of the system. While attributing to this aspect much of the failure of major reform proposals up to now, the group points to the need to draw **lessons from the latest negotiations** to ensure progress in future.

Some methodological elements

The HLG sketches out some of the methodological elements that will inform its deliberations so as to avoid the gridlock in which past proposals have resulted. While any proposals will need to be sound from an **economic and budgetary standpoint** in order to succeed, their success will also depend on careful consideration of the **institutional and political aspects** of the process, including the clustering of decision-makers in subgroups sharing the same interests and objectives.

Along these lines, the report identifies a set of **criteria** against which to evaluate the operation of the own resources system, placing them in two categories:

- **five general economic and financial criteria** (equity/fairness; efficiency; sufficiency and stability; transparency and simplicity; democratic accountability and budgetary discipline); and
- **three EU-specific criteria** (focus on European added value and constraining narrow self-interest; the subsidiarity principle and fiscal sovereignty of Member States; and limiting political transaction costs).

The HLG has selected and defined these criteria, building on the guiding principles set out in the mandate given by the institutions and taking into account recent analyses of the topic. The report notes that the exercise implies a certain degree of subjectivity, with some criteria appearing more difficult to univocally define and interpret than others. For example, past experience is said to show not only that the various decision-makers may have very different interpretations of **fairness**, but also that each interpretation may change over time, depending on domestic priorities.

In addition, individual criteria may partially conflict with each other. The report therefore says that viable reform recommendations should entail a **mix of different own resources**, since jointly these can meet a higher number of criteria.

Further work

Considering that substantial analyses on the functioning of, and possible changes to, the own resources system already exist, the HLG intends to focus in particular on the broader **economic and political context** of reform proposals as well as on their **legal, institutional and procedural aspects**. To begin with, the group has asked external experts to produce a **study** on these topics. In addition, it has identified a number of related **questions that deserve further analysis**, for example:

- whether the call for consolidation efforts at EU level to mirror those at national level is justified;
- whether the euro area is of relevance for the reform process;
- whether previous proposals foundered as a result of their intrinsic features or because of procedural elements;
- whether significant modifications of the system will be impossible without changes in the decision-making mechanism;
- whether differentiated solutions for subgroups of Member States, for example through enhanced cooperation, could make reform happen;
- and whether the traditional approach of linking the negotiations on own resources with those on the EU's multiannual expenditure plans under the MFF may represent a stumbling block or instead ease the way to an agreement on the revenue side of the budget.

This further analysis will serve as the basis for assessing potential candidate new own resources. The objective is to devise viable recommendations to resolve the stalemate experienced up to now despite the rather broad consensus among stakeholders that the current system could be improved.

The way ahead

The HLG carries out this general review of the own resources system along the lines identified in its first assessment report. Regular progress meetings at political level are envisaged (at least once every six months).

In 2016, the HLG will present the results of its analysis, which national parliaments are expected to assess as part of an inter-institutional conference. The same year, in parallel with the planned review of the 2014-20 MFF, the European Commission will examine whether the outcome of the work justifies new initiatives in the field of own resources, with possible reform of the financing of the EU budget for the period covered by the next MFF.

Further reading

First assessment report, High-level Group on own resources, 2014, 48 p.

How the EU budget is financed: The 'own resources' system and the debate on its reform / D'Alfonso A., European Parliament, European Parliamentary Research Service, 2014, 36 p.

Endnotes

[1] Budgetary balances measure the difference between contributions to, and receipts from, the EU budget for each Member State. Apparently simple, the concept is highly controversial. Estimates of Member States' budgetary balances are necessarily based on assumptions, including of the items to be considered in calculating revenues and payments. The net financial position of a given country varies, depending on the chosen definition of balance and the methodology followed to calculate it. In addition, analysts note that the concept is weak from an economic standpoint. As purely an accounting exercise, it results in a 'zero-sum game' in which one participant's gains are balanced by another participant's losses. This cannot reflect positive spill-over effects of EU policies.

[2] EP resolution of 11 March 1999 on the need to modify and reform the European Union's own resources system (OJ C 175, 21.6.1999, p. 238) and EP resolution of 29 March 2007 on the future of the European Union's own resources (P6_TA(2007)0098).

[3] Workshop on the future of EU finances in Berlin, Federal Ministry of Finance, 2014, 54 p.

[4] See endnote 1.

[5] When the 2014 Decision enters into force (tentatively expected in 2015-16), accompanying rules are also set to change with retroactive application from 1 January 2014: Council Regulation (EU, Euratom) 608/2014 sets out the new implementing measures for the own resources system, while Council Regulation (EU, Euratom) 609/2014 establishes how to make own resources available and meet cash requirements. Under the Lisbon Treaty, the adoption of the former required the prior consent of the EP, while on the latter it only needed to be consulted.

[6] In terms of GNI per capita.

[7] This may appear to contradict the rationale behind the 'Fontainebleau principles', which underpinned the creation of the UK rebate, the first correction mechanism. According to these principles, while 'expenditure policy is ultimately the essential means of resolving the question of budgetary imbalances', the contribution of a country should be considered in relation to its relative prosperity.

[8] Annual revision of national contributions to the EU budget / D'Alfonso A., European Parliament, European Parliamentary Research Service, 2014, 10 p.

[9] For a brief overview of the issue in the context of the negotiations on the 2015 EU budget, see for example: The bumpy road to the 2015 EU budget / D'Alfonso A., European Parliament, European Parliamentary Research Service, 2014, 4 p.

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