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Financing the Community budget: The way ahead

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on 23 November 1978)

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CORRIGENDUM to Supplement 8/78 — Bull. EC (English version)

Title page:

For: '(sent by the Commission to the Council on 23 November 1978)'.
Read: '(sent by the Commission to the Council and Parliament on 23 November 1978)'.

Page 21:

Table 8 is replaced by the following:

Table 8 — *Hypothetical taxes on energy*

(1977)

Member State	Tax on petrol %	Tax on total energy consumption %	Estimated GDP key %
Belgium	3.9	4.7	4.9
Denmark	2.1	2.1	2.9
FR of Germany	29.2	27.6	32.8
France	22.1	19.0	24.1
Ireland	1.2	0.8	0.6
Italy	13.7	14.8	12.4
Luxembourg	0.2	0.5	0.2
Netherlands	5.0	8.0	6.7
United Kingdom	22.6	22.5	15.4
	100	100	100

The section entitled 'A tax on energy' (paragraphs 48, 49 and 50) should come under the heading 'Indirect taxes' (page 19).

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The way ahead

Guidelines

1. The Commission has been considering what steps should be taken to meet the situation which will arise when the Community budget becomes too big to be financed entirely by funds accruing from customs duties, agricultural levies and application of a VAT rate which may not exceed 1% of a uniform base, as is provided for in the Council Decision of 21 April 1970.[1]

2. The Commission believes that the developments of the Community will in part be measured by the development of the role of its budget, which constitutes the operational means through which individual actions find their expression. This does not mean that the Commission wishes the budget to grow for its own sake. Indeed it considers that both existing and possible future policies should be judged against the need for constraint in public expenditure. They should also satisfy the condition that they can be more effectively conducted at the Community rather than at the national level. In many cases actions by the Community should take the place of action at the national level, with the result that their inclusion in the Community budget should not lead to an increase in the level of overall public expenditure within the Community. This will of course only be the case if Community actions are carefully chosen to satisfy the condition mentioned above, and if, once decided, the Member States are prepared to see these actions largely or even wholly carried out at the Community level. In other cases Community expenditure, for example on the Social and Regional Funds, should be additional to that undertaken by the Member States, or tackle new problems not yet covered by actions at either the national or the Community level.

3. The Commission has already presented detailed estimates of Community expenditure for 1980 and 1981, in the three-year forward forecasts transmitted with the preliminary draft budget for 1979.[2] These estimates examine each policy in turn. The overall conclusion is that there is a real possibility that the 1% VAT ceiling may be exceeded in 1981. It is plain from the Commission's forecasts that this conclusion is the result of an assessment of a range of factors.

There are two elements already foreseeable which have to be taken into account. Most important, enlargement of the Community to include Greece will involve a net addition to the budget as a result of the extension to the new Member State of existing policies.

The Commission made no allowance in its forecasts for new policies to meet the needs of Greece or for preparatory aid for Portugal, though these possibilities should not be ruled out. Secondly, there is the budgetization of the EDF flowing from renewal of the existing Lomé Convention. This is a desirable change in the form of Community financing of this activity, though not likely to involve amounts critical to the issue of additional resources.

4. There is also the future trend of expenditure on existing Community policies. Of these, agriculture is by far the most important. Here the Commission's forecasts bring out the consequences of policy decisions in this field for future spending. If the increase in agriculture guarantee spending is extrapolated from 1973 it would rise very substantially and leave little room for the development of other policies by 1981 within the existing own resources. If, however, it can be contained more effectively than in the past, the scope for development of other policies is greater, though still inadequate for the development of the major new policies required to meet the challenges now facing the Community and to give a better balance in the range of the Community's actions. The Commission hopes that every effort will be made to contain the cost of agricultural guarantee expenditure and its own proposals will be directed towards this objective.

[1] OJ L 94 of 28.4.1970.
[2] Supplement 6/78 — Bull. EC.

5. Turning to the revenue side of the budget, a common characteristic of the existing own resources is that they lack buoyancy. This is likely to be even more true of customs duties in the future than in the past. The unpredictability of the yield from agricultural levies is also such that it is advisable to guard against an unexpected shortfall. So far as VAT is concerned, the 1978 budget is based on a rate of 0.64% compared with the maximum permitted 1%; for 1979 the rate has not yet been decided but the preliminary draft budget proposed by the Commission (including the letter of amendment implied a rate of VAT of 0.77% while the draft budget resulting from the Budget Council of 20 July 1978 implied a rate of 0.67%.[1] There is thus only a limited margin of VAT left, the more so as VAT as a source of revenue based on consumption expands less rapidly than overall wealth. And it is not acceptable that the present 1% rate of VAT should constitute a ceiling on Community expenditure.

6. For all these reasons, there is no doubt that new revenue will be needed. The only question is when. Although the date cannot definitely be determined now, the Commission believes that in the light of the factors described above the new resources will be needed in time for the 1982 budget.

7. The Community's needs for additional resources could be met in different ways. Borrowing is already source of finance for many Community actions which stimulate investment or are otherwise appropriate for on-lending. The Commission considers that there will be a long-term need for investment in the Community which it may be appropriate to stimulate and coordinate through Community actions. The recent development of Community and Euratom loans and the new Community borrowing instrument are already major advances in this direction. This method of finance must be borne in mind in relation to future Community policies. But given the prospects for growth of the existing range of actions financed from the Community budget and the need to develop further actions for which loan finance would not be appropriate, this will not avoid the requirement to find additional sources of Community revenue, the more so as it is not appropriate to envisage the development of deficit financing as a means of meeting current expenditure needs.

8. A separate possibility would be to revert to the use of financial contributions, instead of increasing the resources due to the Community as of right. The development of a series of political keys to finance individual policies would, however, create many political difficulties. Such a step backwards would be opposed to both the letter and spirit of the Treaties.

9. The Commission believes that it is therefore essential to find a new source of Community revenue. To this end its services have prepared a technical analysis which is annexed. This is deliberately intended to be a neutral examination of the factors relevant to the decision which will be required. Apart from a description of the present system of financing the Community budget and the prospects for expenditure the paper first examines the institutional considerations concerning the choice to be made. Drawing on an analysis of the provisions of the Treaty and on the nature of own resources the paper stresses the need to establish additional true own resources to meet the Community's continuing financial needs. The choice of type of additional revenue must thus lie from within a range of taxes which have the full character of own resources.

10. It then notes the technical considerations which are important, including a harmonized tax base, a buoyant yield and administrative simplicity. The economic considerations are next examined. After analysing the economic concept of taxable capacity the paper notes that this could be applied either to avoid the worsening of present economic disparities (non-regressivity) or to narrow these disparities (progressivity). It points out that if one of these objectives is retained and

[1] Bull. EC 7/8-1978, point 2.3.94.

cannot be achieved through the choice of a range of different own resources, there is the possibility of a corrective mechanism which would adjust the overall economic impact of payments to the Community budget (other than customs duties and agricultural levies). Some of the examples given are related to comparisons based on market exchange rates; the Commission recognizes that there is room for argument as to whether market exchange rates are necessarily the best indicator of economic capacity, though in the budget context it is essential to remember that the same methods have to be applied to both expenditure and receipts.

11. Finally the different revenue options are listed. These range from the simple increase of the VAT ceiling to possible new sources such as transfer to the Community of part of certain existing national taxes. Some of these options are clearly more suitable than others. An idea to be borne in mind in making a choice is the possibility of linking expenditure on particular Community policies with finance from a source associated with those policies; for example, revenue from a tax on energy could be hypothecated to expenditure arising from energy policy.

It is clear that the choice now required must be durable. It is therefore important that it should be capable of being applied in the countries now candidates for membership after enlargement as well as in the existing Member States.

12. The Commission presents this paper to the Council and to the Parliament as joint budgetary authorities so that the discussion which is now necessary about future own resources can be based on as clear an analysis as possible. The Commission for the time being does not intend to present a formal proposal. It believes that there should first be discussion of the various options among the Community institutions and beyond, a discussion in which it intends to play a full part. Nevertheless it believes that it should indicate at this stage the direction of its own thinking.

13. For the Commission, customs duties and agricultural levies belong irrevocably to the Community and should not be modified in any way. The Commission also believes that VAT is a good basis for an own resource, for despite the limitations and problems of the existing system it has the character of a tax which bears on the individual Community citizen. To raise the existing ceiling would also have the advantage of simplicity. However, the Commission considers that it would be useful to study whether it would be possible to ensure that the overall impact of Community resources other than customs duties and agricultural levies should be progressive, and what would be the most appropriate yardstick for achieving this. As a matter of principle, the Commission believes that any element of regressivity should be avoided. This essential condition mut be borne in mind when the final decision is made.

In conclusion, the Commission again draws attention to the inevitability of the need for a decision, and to its expectation that additional resources will be required in time for the 1982 budget. In view of this, and of the need to allow time for the necessary ratification procedures at national level to be completed, the Commission thinks that a decision on the new own resources will be needed in 1979. The Commission will make a formal proposal in due time.

Financing the Community budget

Introduction

1. This paper is an analysis of the different factors and options to be borne in mind in considering the choices before the Community for an increase in the resources available to finance the Community budget.

Part One

The present system of financing the Community budget

2. Apart from a small amount of miscellaneous revenue the Community budget is at present financed (in accordance with the Decision of 21 April 1970) by customs duties, agricultural levies and a contribution from the Member States related to their shares in Community GNP. The Decision envisages that the budget, irrespective of other revenue, should be financed by the Communities own resources and, to this end, the GNP contributions are expected to be replaced in 1979 by the proceeds of a Community rate of VAT which cannot exceed 1%. In the view of the Commission the expression 'own resources' signifies revenue of a fiscal nature belonging once and for all to the Communities for financing its budget as of right and without the need for any subsequent decision by national authorities.

(a) Customs duties result from the fact that the Community is a customs union with common duties levied on certain goods entering the union but no duties on internal trade. Since external duties on imports are collected on the periphery of the union without regard to the place of consumption it is natural and logical that the duties should belong to the Community rather than to the Member State which collects them. To this extent they are an ideal own resource for the Communities. Customs duties are, however, levied for commercial or regulatory reasons and have economic and political, rather than financial, objectives. It is also international policy that they should be gradually reduced and even eventually disappear. Although a logical and inevitable own resource, the fact that it is a declining one, in real terms, has consequences for financing the budget in the medium term.

(b) Agricultural levies are also the product of a Community policy and the place where they are collected is not necessarily the same as the place where the products are consumed.

Like customs duties, they are therefore a logical own resource. Also like customs duties, however, they are not levied for the purpose of financing the budget. Their yield depends on trade, price and monetary fluctuations; it is therefore not constant and is difficult to forecast. Thus agricultural levies, although a logical and inevitable own resource, cannot respond to the needs of a growing Community budget.

(c) GNP contributions are provided for in the Decision of 1970 as a temporary method of financing until VAT is introduced. They are calculated in relation to the average share of each Member State's GNP in the GNP of the Community in the first three years of the five-year period preceding the year in question.

(d) Value Added Tax was included as a Community own resource by the Decision of 1970 partly because the tax existed already and it was Community policy to harmonize its structure and partly because it was thought to be a tax which, since it affects every citizen of the Communities, would be seen as a direct contribution to Community financing. In practice it has not yet turned out as envisaged since a number of temporary exceptions from the harmonized common tax base still exist. Also, and partly as a result of this, the Council has given Member States a choice between two methods of assessment of the amount of own resources payable to the Community:

(i) directly on the basis of tax-payers' information on the taxable base as returned to the national tax administrations;

Table 1. — *Trend in customs duties*[1]

(million EUA)

	1971	1972	1973	1974	1975	1976	1977
BLEU	171.8	185.9	218.8	253.3	236.2	284.2	307.5
FR of Germany	738.8	801.1	943.2	1 058.5	1 044.6	1 288.1	1 378.8
France	378.8	434.4	519.6	555.6	547.6	654.8	669.6
Italy	309.8	316.9	345.5	409.4	341.5	407.5	426.1
Netherlands	250.6	251.7	300.3	351.8	338.7	395.6	441.5
Total (the Six)	1 849.8	1 990.0	2 327.4	2 628.6	2 508.4	3 030.2	3 223.5
Percentage variation (±%)		+7.6	+17.0	+12.9	−4.6	+20.8	+6.4
Denmark	—	—	110.5	105.2	106.0	140.5	134.0
Ireland	—	—	—	—	31.7	40.6	42.4
United Kingdom	—	—	—	—	882.7	980.2	1 059.0
Total (the Nine)	—	—	—	—	3 528.8	4 191.5	4 458.9

[1] The breakdown into protective and fiscal duties is not available.

(ii) on the basis of the total actual VAT revenue and an estimated average VAT rate from which is calculated an estimated taxable basis.

This latter procedure must be abolished after the initial five-year period. The Commission will also pursue continued adjustments towards the common, truly harmonized tax base. When this is reached, the consumer will be able to calculate his contribution to the Communities out of each transaction, as the current Community VAT rate multiplied by the price before tax.

3. Tables 1 and 2 show the amounts and rates of growth, in money terms, of customs duties and agricultural levies (including sugar contributions) collected in the Community from 1971 to 1977. Customs duties exclude certain fiscal duties collected by the United Kingdom and Ireland which have now been

Table 2. — *Trend in agricultural levies (including sugar contributions)*

(million EUA)

	1971	1972	1973	1974	1975	1976	1977
BLEU	72.0	67.2	30.3	17.3	61.9	149.8	265.3
FR of Germany	182.3	215.7	145.9	110.0	146.5	254.9	447.6
France	110.3	145.1	88.2	66.5	74.0	116.7	178.2
Italy	213.9	237.6	123.7	58.3	106.6	220.3	479.4
Netherlands	121.1	126.5	94.8	32.9	128.2	317.8	449.8
Total (the Six)	699.8	792.1	482.9	285.0	517.2	1 059.5	1 820.3
Percentage variation (±%)		+13.2	−39.0	−40.9	+81.5	+104.9	+71.8
Denmark	—	—	4.9	5.8	6.9	18.2	31.0
Ireland	—	—	3.7	5.7	4.2	8.4	28.0
United Kingdom	—	—	55.2	68.8	97.9	102.4	284.2
Total (the Nine)	—	—	546.7	365.3	626.2	1 188.3	2 164.3
Percentage variation (±%)				−33.2	+71.4	+89.9	+82.1

Table 3. — *Percentage of own resources compared with gross national product*

	1971	1972	1973	1974	1975	1976	1977
Customs duties '6'	0.36	0.34	0.34	0.34	0.29	0.30	0.29
Customs duties '9'					0.32	0.34	0.32
Agricultural levies and sugar levies '6'	0.13	0.14	0.07	0.04	0.06	0.11	0.16
Agricultural levies and sugar levies '9'			0.06	0.04	0.06	0.10	0.16
Total (the Six)	0.49	0.48	0.41	0.37	0.35	0.41	0.45
Total (the Nine)					0.38	0.43	0.48

converted into internal taxes, as is the practice in the other Member States. The amounts paid to the Community during this period were different because the Decision of 1970 and the Treaty of Accession provided that these should be paid on a progressive basis up to the end of 1977.

4. Table 3 shows the relationship, during the same period, between customs duties and agricultural levies and GNP. It illustrates that customs duties have declined, in real terms, during the period; this decline will be accentuated when the effects of the current GATT negotiations begin to be felt.

5. Tables 4 and 5 show for 1978 and 1979 the forecast geographical origin of the various components of financing the budget. No account has been taken of the extra-budgetary effects of Article 131 of the Treaty of Accession because it does not operate after 1979. As already noted, customs duties and agricultural levies are collected on behalf of the Community. The amounts collected are not necessarily finally paid by the citizens of the State where the collection is made (for example: the Rotterdam and Antwerp situation).

6. While the receipts of the budget are financed by the methods described under 2, the expenditure side of the budget provides for a 'financial mechanism' which could result in payments from the budget to Member States in a special economic situation whose

Table 4 — *1978 (Amending budget)*

Member State	Agricultural levies	Customs duties	GNP contributions	Total
Belgium	14.1	6.7	4.5	7.0
Denmark	2.7	3.5	2.6	3.0
FR of Germany	20.9	30.4	32.1	29.5
France	9.2	15.3	23.9	18.0
Ireland	0.8	1.0	0,6	0.8
Italy	19.2	10.0	13.2	13.0
Luxembourg	—	0.1	0.2	0.1
Netherlands	22.3	10.1	6.0	10.4
United Kingdom	10.8	22.9	16.9	18.2
Total	100.0	100.0	100.0	100.0

Table 5 — *1979 (Preliminary draft budget)*

Member State	Agricultural levies	Customs duties	VAT	Total
Belgium	11.1	6.7	5.2	6.7
Denmark	2.1	2.5	2.6	2.5
FR of Germany	21.5	30.5	32.4	30.0
France	10.8	15.1	24.0	18.8
Ireland	0.7	1.1	0.8	0.9
Italy	19.1	9.5	10.4	11.5
Luxembourg	—	0.1	0.2	0.1
Netherlands	17.2	9.4	6.3	9.1
United Kingdom	17.5	25.1	18.1	20.4
Total	100.0	100.0	100.0	100.0

economies make a disproportionate contribution to budget finance. This system is applicable temporarily and experimentally for a period of seven years from mid-1976 and until now has not been called into play. The 'mechanism' operates in favour of any Member State fulfilling the following conditions.

(i) *per capita* GNP is less than 85% of the Community average;

(ii) *per capita* GNP growth rate, in volume terms, is less than 120% of the Community average rate;

(iii) the payments made for the overall financing of the Community's budget exceed by more than 10% the sum which would have been paid if financing had been on the basis of GNP.

The calculation of the amount to be paid is complex but approximates to an income tax system in that successive slices of the 'excess contribution' attract higher rates of repayment.

7. The total amount payable in any one year is limited to 250 million EUA or 3% of the budget, whichever is the higher. Within this overall limit, however, other limitations apply. The payment may not exceed the smaller of either:

(a) the net transfers from the Member State to the Communities (thus, a Member State benefiting from the mechanism can never be a net recipient from the budget); or

(b) the Member State's VAT payments—or GNP equivalent if VAT is not applied (i.e. no part of a Member State's budget payments by way of customs duties or agricultural levies can be repaid under this mechanism).

8. The system outlined under 7 applies when the Member State in question has a deficit on current balance of payments. If it has a surplus, then the calculation to establish whether the share of budget finance is disproportionate is based on the difference between the relative share of VAT own resources and the relative share of Community GNP.

Part Two

The relationship between existing sources of finance and Community expenditure

9. As will be seen from this description of the present financing system, Community expenditure cannot at present exceed the resources available from customs duties, agricultural levies and as far as 1% of VAT. These resources will tend to grow, in the next decade, significantly slower than the growth of GDP. On the other hand, there are various factors, notably enlargement to a Community of Twelve, which indicate that expenditure should grow faster. It is therefore necessary to consider how soon the present ceiling will be reached.

10. In its three-year forecasts 1979-1981,[1] the Commission explained two possible hypotheses under which Community expenditure might grow in the years in question. The first assumed an extrapolation of EAGGF Guarantee expenditure from 1973 and the lower limits of a desirable bracket of expenditure in the social, regional, energy and development aid sectors. The second represented a more dynamic approach, involving a limitation of EAGGF Guarantee expenditure and the upper limits of the desirable brackets of expenditure in the other sectors.

11. The Commission then compared the expenditure resulting from these two hypotheses with forecasts of own resources based firstly on a GDP growth in real terms of 3.5% a year and secondly on a growth of 4.5% a year. Under the first hypothesis the VAT rate in 1981 would be 1.12% with the lower GDP assumption and 1.08% with the

[1] Point 3.

higher. Under the second hypothesis the rate would be 0.99% and 0.95%.

12. The Commission recognizes the need to examine existing expenditure thoroughly, so as to eliminate unnecessary costs, before an addition is made to the resources available for financing the budget. In the second of its hypotheses, mentioned above, the Commission has already allowed for a limitation of EAGGF Guarantee expenditure which represents two-thirds of the budget; whether such a limitation will take place depends largely on the political will of the Member States. For the remaining expenditure, the scope for significant reduction appears to be limited. In any case, the reductions which could be effected would not seriously influence a judgment on when the present VAT ceiling of 1% will be reached.

13. Although its three-year forecasts envisage the possibility that the present 1% VAT ceiling may be reached during 1981, the Commission believes that temporary financing measures could be arranged, if necessary, to finance the budget of that year. It is convinced, however, that planning should be based on an assumption that an increase in the resources available to the Community will be needed in time to finance the 1982 budget.

14. The Commission's forecasts up to 1981 have envisaged a budget of broadly the same nature as at present and it is clear that the revenue of the Community will have to be increased to finance even such relatively modest expenditure. But an examination of the possible methods of increasing the Community's resources should be made against the background of the way the budget may develop in the longer term, because this may have an effect on the choice to be made.

15. In the longer term, the most obvious factor which influences the present scope of the Community budget is the proposed enlargement to a Community of Twelve. There is already a broad measure of agreement that enlargement will entail substantial additional expenditure and that it will be necessary to develop policies designed to reduce divergence among the areas of an enlarged Community.

16. Equally, over the years the development of actions at the Community level should substantially increase the size of the budget. In some critical areas this would necessarily involve an increase in the total level of public expenditure, as Community actions would be additional to national actions. But in many other areas it should be the aim to secure greater efficiency through transfer of specific actions from national to Community responsibility with a corresponding reduction in expenditure at the national level to the extent that this occurs.

17. Looking ahead, even beyond the decision required in the short term, it is also often accepted that the disciplines imposed by a developing economic and monetary union on weaker parts of the Community will need to be accompanied by measures at the Community level intending to offset the pressures for widening divergency between richer and poorer areas of the Community. As progress is made in this direction the redistributive effect of the budget will have to be given increasing weight. The short term development of the scale and nature of additional Community revenue should be compatible with these longer-term perspectives.

Part Three

Institutional considerations

18. The methods which are used to finance the Community budget demonstrate the political development of the Community. Thus at the outset the Community was financed by contributions from the Member States based on fixed percentages (Article 200 of the EEC Treaty). But it was the wish of the authors of the Treaty that this system should be replaced by one in which the Community

is endowed with its own resources (Article 201).

19. In this perspective it is clear that an own resource has a fiscal nature, must be a direct charge on individuals or companies in the Community and be independent of decisions by the Member States; there must also be an automatic link between the Community and the source of revenue, i.e. each economic operation on which the Community tax is levied. Even if the own resource is collected by the Member States this is done on the Community's account.

The revenue is not part of the income of the Member States and ought not to need to be either incorporated into their national budgets or voted by national parliaments.

20. By these criteria, customs duties and agricultural levies are indeed pure own resources. The whole of their revenue belongs immediately to the Community. The political decisions which determine the level of taxation are taken by the Community institutions. There is no question of their belonging to the Member States, and indeed their geographical origin does not fully coincide with the economic burden to which they give rise.

21. At present the third own resource, VAT, which is about to be introduced, is less pure because of the transitional arrangements which mean that initially its burden may be calculated on a statistical basis. In addition, the Community VAT, limited at present to 1%, is only a small part of total VAT of which the taxpayer bears the burden. As a result this source is seen as a whole to continue to belong to the Member States.

22. Against this background it is important that the Community's system of financing should continue to develop towards true own resources. There can be no question of reverting to financial contributions from the Member States. To do so would be contrary to the Treaty. It would, moreover, tend to focus attention on the already latent concern with *juste retour* in the Member States and could make it more difficult to achieve progress towards the development of Community actions which will be essential if the Community is to meet the challenges facing it both now and in the future as increased convergence is attempted and attained.

23. It is also important to bear in mind the consequences which such a route would have for the European Parliament. The Parliament has its main powers in the budgetary field. It has claimed these because there is a clear need at the level of the Community for the taxpayer to be represented at the moment of decision on the expenditures and corresponding revenue to which he is called upon to contribute. There has been a definite link in the past between the growth of the budget power of the European Parliament and the development of the Community's own sources of finance. Were the Community to be financed by contributions voted by national parliaments the foundation of the European Parliament's powers in this field would be diminished. This would be unacceptable.

24. The institutional considerations suggest that the Community should move towards the establishment of additional true own resources to meet its financing needs. One possibility is the development of Community VAT. There are others as well. It is essential, however, that short-term decisions should be placed in the context of a long-term commitment to the principle that Community taxes are the basis of Community finances, so that decisions now do not make it more difficult to achieve a final solution of this kind. In this way the system of financing chosen should contribute to the strengthening of the Community as a whole.

Part Four

Technical considerations

25. In addition to these institutional considerations there are a number of considerations

of a technical nature which have to be taken into account. From this point of view it would be desirable that a new own resource should have the following characteristics even if it is clear that not all of them will be found in any one resource.

(a) The tax base must be harmonized so that the same operations are taxed in each Member State.

(b) It should have a wide field of application so as to be seen as a truly Community tax and not one confined to a narrow sector of the economy.

(c) It should have a high and buoyant yield. Since the choosing of an additional resource is likely to be a difficult and lengthy process it is highly desirable that the process will not need to be repeated again for at least a decade. Indeed, it would be best to choose a taxable base to which a Community rate of tax could be applied which could be increased each year within only the limits of what is politically and fiscally acceptable. The tax should ideally be buoyant and should increase in yield, in real terms, at least as fast as the general rate of economic growth.

(d) It should present the least possible scope for tax evasion.

(e) It should be administratively simple and not entail the setting up of a new large tax-collecting organization in the Member States or additional administrative burdens on taxpayers. To this extent, it would need to be an existing tax or a new tax which would be collected by existing organizations in the Member States, or directly by the Commission, without much additional staff.

Part Five

Economic considerations

Taxable capacity

26. It is also necessary, before examining the possibilities of adding to the Communities' resources, to consider the broad principles of taxable capacity (or ability to pay). It is a long established principle of taxation that the burden should be equitably distributed, in the sense that taxpayers with the same abilities to bear taxation should bear the same burden and those with greater capacities should bear more. Those with greater capacities can either simply pay more in proportion to the size of their income or they can pay progressively. In order to give this concept of taxable capacity operational force, some indicator is needed. The indicator of taxable capacity must be quantifiable on a harmonized basis throughout the Community.

27. Traditionally, the main candidates have been income, consumption and wealth. Wealth can be discarded in considering the indicators of capacity to contribute to the Community budget. Income is a broad indicator of economic power, and one which is independent of how taxpayers allocate their income between consumption and savings or between particular items of consumption; it fluctuates little year by year.

28. Harmonized national accounts data exist for income, although income is defined in a number of ways so that a choice would be required if income is used as the indicator of taxable capacity. For example national income, unlike Gross Domestic Product, excludes the depreciation of the country's capital stock, so it is closer to the concept of income as the net accretion of resources over time. Another possibility is total personal income, but its relationship to national income will vary according to the relative importance of wages and profits and the relative importance of private as opposed to corporate firms.

29. Consumption is also the subject of a harmonized national accounts definition though there is less scope for alternative definitions than for income. It has a narrower relationship than income to overall national economic resources, and is affected by such factors as the importance of savings and investment, the presence of a trade deficit (im-

Table 6 — *Relative sizes of Member States' income and consumption in 1976*

Member State	GDP	National income	Private consumption	Personal income	Per capita GDP as % of Community average	Population	
	as % of Community total					1 000	%
FR of Germany	32.14	31.70	31.78	31.40	135	61 531	23.78
France	25.03	25.00	25.37	23.72	122	52 921	20.45
Italy	12.24	12.50	13.22	12.30	56	56 169	21.70
Netherlands	6.44	6.57	6.95	6.74	121	13 773	5.32
Belgium	4.75	4.88	3.70	4.23	125	9 818	3.79
Luxembourg	0.17	0.15	0.15	0.18	123	356	0.14
United Kingdom	15.91	15.77	15.58	17.98	73	56 001	21.64
Ireland	0.57	0.62	0.60	0.57	47	3 162	1.22
Denmark	2.75	2.81	2.65	2.87	141	5 073	1.96
EC 9	100.00	100.00	100.00	100.00	100.00	258 805	100.00

Source: SOEC National Accounts 1977.

ports are covered but exports are not, so the relative importance of consumption is reduced if exports exceed imports) and the importance of government spending. As a result it fluctuates from year to year. Overall it tends—at Community as well as national level—to bear more heavily on the poorer than on the wealthy, and on the States with poor economic performance harder than on the more successful.

30. A judgment of the two approaches must depend on the weight given to these factors. It should be noted that no Member State has made a complete choice and that each has both forms of tax, though the balance varies.

31. These measures of taxable capacity relate to the total income or consumption of Member States. The indicators which would result from them are illustrated in the first four columns of Table 6 which shows the relative sizes of Member States income and consumption *per capita* as a percentage of the Community average and also population. They are indicators of capacity to pay on a proportional basis only and not on a progressive basis.

Avoiding the worsening of economic disparities

32. If the concept of taxable capacity is retained, the first option is to avoid the worsening of economic disparities. This would require that the overall impact of Community taxation should be brought into line with the indicator of taxable capacity chosen—be it income or consumption (on one of the definitions in the first four columns of Table 6).

Reducing economic disparities

33. A second option, to be considered as progress is made towards the objective of economic and monetary union, and in the context of enlargement to a Community of Twelve, is to seek to reduce economic disparities. In most Member States, both the expenditure and revenue sides of the budget seek in part to do this.

34. Significant transfers of resources between individuals and between regions is provided for by expenditure policies in most national budgets. The Community budget has at present little redistributive effect be-

cause two-thirds of it is devoted to agricultural Guarantee expenditure which has specific objectives and also does little to reduce economic disparities between Member States. The Regional and Social Funds have clear redistributive objectives but expenditure from them is relatively small and their redistributive impact is at present limited. Nevertheless, as the budget grows it could be used more and more to incur expenditure specifically designed to reduce differences between regions. The whole of the redistribution required could be achieved by expenditure policy but it might be desirable to combine this with an element of redistribution through adjustments of the overall impact of receipts for financing the budget. Redistribution on the expenditure side can more easily be used to correct specific cases of disparity within Member States. On the other hand, if it is decided to undertake a substantial effort of redistribution, it should be borne in mind that if the revenue side is used to promote convergence of the economies of Member States, a smaller budget is required to produce a given net result than if the same effect is achieved solely through expenditure.

35. On the receipts side, just as at the national level, an individual with a higher income than another has a more than proportionately greater taxable capacity of the two, (i.e. that he should pay at progressively higher rates as his income increases) so it could be argued that a State with a higher *per capita* income than another has a progressively larger taxable capacity. A progressive system for financing the Community budget could be introduced. This would require a political decision on the rate at which taxable capacity rises for a given percentage increase in income.

36. In practice this idea could be implemented by deciding that a given difference in income should be associated with a higher rate of tax. For example, a 10% difference of income could give rise to a 13% difference of tax (elasticity of 1.3—other elasticities being equally possible). The calculation could be based on national income, consumption, GDP or total personal income. Shares in revenue would be obtained by applying the elasticity in question to the *per capita* indicator chosen and then multiplying the result by population size. It thus combines allowances for differences in the size of countries and differences in their *per capita* situation. It might also be possible, if the data could be found on an adequate basis, to use personal income by bands within each Member State.

Putting measures of taxable capacity into effect

37. If it is decided to adopt the option of avoiding the widening of economic disparities or that of reducing them, there are two possible approaches.

38. The first option is to choose sources of revenue (customs duties and agricultural levies apart) which have an overall impact at least broadly in line with the measurement of taxable capacity chosen. This may require the adoption of a mixture of tax sources. In effect, the present VAT base is only in some cases close to one measure of taxable capacity as is shown in Table 7. In only five Member States is the yield of a given VAT

Table 7 — *Evaluation of taxable capacity*

Member State	Estimated GDP 1979 %	Estimated VAT 1979 %	Difference %
Belgium	5.05	5.22	+ 3.37
Denmark	2.68	2.58	− 3.73
FR of Germany	31.30	32.40	+ 3.51
France	23.76	23.95	+ 0.80
Ireland	0.68	0.77	+13.24
Italy	12.82	10.43	−18.64
Luxembourg	0.19	0.21	+10.53
Netherlands	6.57	6.32	− 3.81
United Kingdom	16.95	18.12	+ 6.90
Total	100.00	100.00	

percentage within ±5% of GDP; in the other cases it bears more heavily on three (Ireland, Luxembourg and the UK) and less heavily on one (Italy). Given the relative GDP shares it would thus seem that the present VAT base is regressive in some cases. The overall impact of VAT could be corrected by a new revenue source which offsets this tendency.

39. If this were not possible—and it will be seen from the following section that there does not seem to be a short-term possibility—a corrective mechanism could be applied. This should not be based on each individual resource, for if it were there could be discrimination between taxpayers. Rather, it should be based on the overall impact of revenues so as to bring this into line with the chosen indicator of taxable capacity. It would be essential that such a mechanism should operate automatically, on the basis of the initial Community decision which would lay down the appropriate economic variables and the method by which they would be applied each year. Thus the initial decision would specify the requirement of non-regressivity or alternatively lay down a level of progressivity, which could not be changed except by a subsequent decision. Customs duties and agricultural levies would of course be excluded from the scope of this correction. The rate of Community tax to be applied each year would be decided separately by the Council and the Parliament in the course of the annual budgetary procedure.

Part Six

Possible sources of additional revenue

40. This section summarizes the main advantages and disadvantages of the principal possible sources of additional revenue for the Community budget.

Indirect taxes

VAT

41. The main advantage of obtaining additional revenue from VAT is that in principle the tax base is already harmonized and it is accepted as a Community own resource. The simplest course, therefore, would be to increase the rate of VAT above 1%. The yield of a 1% VAT rate is roughly equivalent to 0.5% of Community GDP. Since customs duties and agricultural levies produce about 0.4% of Community GDP, an increase of the VAT rate to 2% would enable the budget of 1982 (purely as an example) to have a maximum potential expenditure of about 1.4% of Community GDP. On a minimalist assumption of growth, and not taking any account of the new policies which enlargement may require, or of actions developed in the context of moves towards economic and monetary union, it can be envisaged that a 2% VAT ceiling would be reached at about the end of the 1980s. An increase in the Community VAT rate would call for a renewed drive to abolish the remaining exemptions from the truly harmonized tax base and for a change to a procedure of levying the VAT own resources which is independent of statistical estimates. It will also be desirable to try to reduce the incidence of tax evasion which is known to be different in different Member States and which can therefore give rise to distortions.

Cigarette duty

42. The excise duty on cigarettes is partially harmonized but the duty on other tobacco products is not. In the case of cigarettes, the absolute level of the duty throughout the Community is such as to warrant considering transferring to the Community a substantial part of it as additional revenue. A transfer to the Community of 0.15 EUA per packet of 20 cigarettes would produce about 3 700 million EUA (1975 consumption levels) which represents about 0.3% of Community GDP. (The whole of the tobacco taxes in

1977 represented about 0.8% of Community GDP.) However, because of differences in cigarette consumption between Member States, their relative burdens would differ substantially from their relative national incomes per head.

Alcohol duties

43. Although the Commission has proposed the harmonization of the duties on beer, wine and on spirits, there is no wine duty in one Member State and it applies to only part of consumption in two others. Because there are substantial differences in the structure of consumption between member countries the alcohol duties need to be considered together.[1] However, in the absence of a sufficient degree of harmonization, the alcohol duties cannot be considered as an own resource; this might be possible in the future if the Council adopts the Commission's proposals for harmonization. Because of the lack of harmonization of the tax base it is not possible to estimate the yield from a specific Community tax. It can be noted, however, that in 1976 the whole of the tax revenue from alcohol represented about 0.6% of Community GDP.

Direct taxes

Corporation tax

44. The inclusion as a Community own resource of all or part of corporation tax cannot be envisaged unless there were to be first a harmonization of its field of application and of its tax base. In this respect the differences in legislation in the different countries are considerable; for example, depending on the country, a partnership might be subject to corporation tax or to personal income tax—that is, taxation as individual associates. Also, tax base rules, apart from this complexity, change often under the pressure of economic policy. Even if these problems were overcome, a corporation tax could be criticized as a Community own resource because it would discriminate against countries with relatively large corporate sectors. The Commission has announced its intention of approximating the rules concerning the assessment of this tax, but this is an extremely complex operation which could not be completed on the timetable required in the present context.

Personal income tax

45. It does not seem to be possible to envisage the direct application of a rate of Community income tax to individuals for the time being. In order to achieve this, it would be necessary to harmonize the tax base throughout the Community so as to eliminate substantial differences between Member States.

46. The Commission has indicated that it does not intend to propose harmonization of the base for income tax. To do so would be even more complicated than harmonizing the tax base for Corporation tax because it includes many additional elements such as agricultural earnings, rents from buildings and land, salaries and wages and professional earnings.

47. It would be possible to create, alongside national income taxes which were not harmonized, a Community income tax with its own definition of the tax base. Even if the difficulties of such an operation, which are considerably, could be overcome, there would need to be arrangements for avoiding double taxation and for ensuring that individual taxpayers did not pay more in total than under the national rules. This solution would therefore impose considerable administrative burdens (double declarations by taxpayers, double accounting by firms, double tax control, etc.).

[1] e.g. beer consumption per head varies from 14 litres in Italy to 151 in Denmark, wine from 6 in the UK to 101 in France.

For all these reasons, this solution does not seem to be practicable in the context of the decisions which must now be made.

A tax on energy

48. A Community tax on the production of energy would not be consistent with the energy policy objectives of stimulating production. If adopted it should be accompanied by a tax on imports where the implications for GATT would need to be explored. There is, at first sight, scope for a Community tax directly related to one of the objectives of Community energy policy, namely the reduction of energy consumption. But it should be applied to all forms of consumption. It is necessary to consider carefully the economic effects of the different stages at which the tax might be levied and in view of the difficulties of harmonization it cannot be envisaged in time for application in 1982.

49. However, a Community tax simply on petrol would be defensible from the point of view of energy policy. It would be relatively simple to apply but the yield would probably not be very large unless a substantial proportion of existing taxes were to be transferred to the Community.

50. A tax on petrol of 20 EUA per tonne of oil equivalent (0.16 EUA per 10 litres) would produce about 1 600 million EUA at 1977 volumes or about 0.13% of Community GDP. A theoretical tax of 3 EUA per tonne of oil equivalent on total energy consumption would produce about 2 800 million EUA at 1977 volumes or about 0.23% of Community GDP. Table 8 shows how these taxes would be shared among Member States.

Table 8 — *Hypothetical taxes on energy (1977)*

Member State	Tax on petrol %	Tax on total energy consumption %	Estimated GDP key %
Belgium	3.9	4.7	4.9
Denmark	29.2	27.6	32.8
FR of Germany	22.1	19.0	24.1
France	13.7	14.8	12.4
Ireland	0.2	0.5	0.2
Italy	5.0	8.0	6.7
Luxembourg	2.1	2.1	2.9
Netherlands	1.2	0.8	0.6
United Kingdom	22.6	22.5	15.4
	100	100	100

Short-term possibilities

51. This paper has discussed the need for additional revenue in the short term (i.e. one which could be brought into effect in 1982). Within the time-scale envisaged, the choice seems to be limited to one or more of the following possibilities:

(a) an increase in the Community VAT rate;

(b) the transfer to the Community of part of the tax on cigarettes;

(c) the transfer to the Community of part of the tax on petrol.

52. It would be only in the medium term (when difficulties of harmonization have been resolved) that these might be supplemented by a tax on energy consumption and/or by the transfer to the Community of the whole or part of taxes on alcohol.

53. A corrective mechanism based on taxable capacity could be applied to adjust the overall impact of all receipts (except customs duties and agricultural levies); this could aim either at non-regressivity or at progressivity.

54. In 1976, purely as an illustrative guide, the potential revenue from these possibilities would have produced the following percentages of Community GDP:

Customs duties and agricultural levies 0.43%

1% VAT 0.50%

A tax of 0.15 EUA on a packet of cigarettes (The whole of the tobacco taxes represents 0.82%)	0.30%
A tax on petrol of 20 EUA per tonne of oil equivalent (The whole of the petrol taxes revenue represents 1.20%)	0.13%
A tax on total energy consumption of 3 EUA per tonne of oil equivalent	0.23%
The whole of the alcohol taxes revenue represents	0.60%

55. So far as tobacco, petrol and energy consumption are concerned, these figures represent a situation in which the tax base not yet been harmonized. The figures are intended to indicate broad areas of magnitude only. They illustrate, nevertheless, that the Community budgets in the short and medium terms will have to rely predominantly on VAT as a source of revenue.

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The Commission has sent a report to the budgetary authority (Parliament and the Council), which analyses the measures to deal with the need for more funds for the Community budget when Community own resources prove inadequate for the purpose.