European Communities
Commission
Background Report
ISEC/B2/79

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FINANCING THE COMMUNITY BUDGET

Summary

Looking Ahead

By 1982 Community budgetary expenditure is likely to exceed the revenue available for financing it from the present elements of 'own resources', and the European Commission has felt it necessary to draw the attention of the Council of Ministers to this matter well in advance.

It has therefore sent the Council a discussion paper (1) setting out various ideas for consideration but, without as yet, coming forward with any concrete proposal for supplementing finances. The Commission believes that any regressivity (i.e. the less well-off paying proportionately more than the better-off) should be avoided and that a system that was actually progressive should be considered, under which a state with a higher income should contribute to the budget at progressively higher rates.

Reasons for concern

The Commission points out that there are a number of reasons why, even with tighter control of agricultural spending, the size of the budget will increase with the years. For example, the entry of Greece into the Community will involve a net addition to the budget, as will preparatory aid for Portugal; more finance may be required for the European Development Fund. The present Lome Convention is replaced in 1980, while major new policies will be required both to meet challenges now facing the Community and to give a better balance in the range of Community action.

But, as at present constituted, own resources lack sufficient buoyancy to finance such developments after 1981. While income from agricultural levies and customs duties remains fairly static, the more elastic part of own resources - the contribution from Value Added Tax - is at present limited to a maximum rate of one per cent of transactions within the harmonised VAT base. The Commission estimates that had its preliminary budget for 1979 been adopted this would have implied a rate of VAT of 0.77 per cent; the actual budget is likely to be less than that but, depending on different economic criteria including economic growth rates, the Commission foresees that by 1981 the rate could be 1.12 or 1.08 per cent.

While it would no doubt be possible to offset this excess by alternative temporary means of finance, the Commission notes that by 1982 the situation will have to be squarely faced, and it would like the Council to take some decisions on the matter during 1979.

(1) COM(78)531 of 21 November, 1978.

Criteria for new revenue

The Commission points out that the methods which are used to finance the Community budget demonstrate the political development of the Community. Thus, while at the outset the Community was financed by contributions from the Member States on fixed percentages, 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.

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.

Because of delays on the part of four Member States (not Britain) to agree the VAT base, even the 1979 budget will not be totally financed from own resources. However, the Commission insists that there can now be no going back to direct financing, but in deciding on new taxes it is essential to bear in mind ability to pay and to avoid accentuating disparities between member countries. In addition any new formula must be lasting and applicable to new entrants.

Some suggestions

The Commission points out that the easiest way to increase the revenue would be to raise the VAT rate above 1 per cent. The yield of a 1 per cent VAT rate is roughly equivalent to 0.5 per cent of Community GDP. Since customs duties and agricultural levies produce about 0.4 per cent of Community GDP, an increase of the VAT rate to 2 per cent would enable the Budget for 1982 (purely as an example) to have a maximum potential expenditure of about 1.4 per cent of Community GDP. On a minimalist basis the 2 per cent VAT ceiling might last to the end of the 1980s, but an increase in the rate would call for a renewed drive to abolish the remaining exemptions from the truly harmonised tax base and for a change to a procedure of levying the VAT own resources which is independent of statistical estimates.

The Commission suggests, however, that it may be necessary to think in terms of a mixture of taxes to allow of future flexibility. Indirectly such taxes might be levied on cigarette or alcohol duties, or there might be a Community tax on the production of energy or its consumption. Direct taxes, such as corporation or personal income tax, the Commission considers to be impracticable at the present time.

Any new tax obviously presents difficulties, but with 1982 as an operative date the Commission believes that the choice may be limited to one or more of three possibilities: an increase in the Community VAT rate, the transfer to the Community of part of the tax on cigarettes, and the transfer of part of the tax on petrol. The other taxes might be part of a longer-term programme.

A tax on cigarettes or petrol would require harmonisation of the tax base, but the Commission tentatively concludes that, even if agreement can be reached on these, Community budgets in the short and medium terms will have to rely predominantly on VAT as a source of revenue.

ANNEX

GEOGRAPHICAL ORIGIN OF THE VARIOUS COMPONENTS OF FINANCING THE BUDGET

	1978 (Amending Budget)			
	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
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

	1979 (Preliminary Draft Budget)			
	Agricultural Levies	Customs Duties	VAT	TOTAL
Belgium	11.1	6.7	5.2	6.7
Denmark	2.1	2.5	2.6	2.5
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

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