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Financing the European Union

Commission Report on the Operation of the Own Resources System

Executive summary

The object of the present report is to review the performance of the EU own resources system, including the search for new own resources as well as the possibility of applying a fixed rate of call for the VAT resource; and to examine the correction mechanism in favour of the United Kingdom and the issue of contributions to the EU budget raised by several Member States.

The EU ***own resources system*** has evolved considerably over time and, following modifications introduced by the 1988 and 1994 Own Resources Decisions, the equity among Member States of gross contributions to the EU budget has improved substantially as they have become more aligned with their respective shares in EU GNP. This improvement has been primarily a result of the increasing importance of the GNP resource in total budget contributions. The current system has also provided the resources necessary to finance EU expenditure. However, the present system has shown shortcomings in at least two respects. By relying increasingly on transfers from Member States treasuries, the system has not secured genuine financial autonomy for the EU; and various interventions in the contributions system, including the correction mechanism in favour of the United Kingdom, have inhibited transparency in the financial relationships of the Member States and the EU budget.

Reform of the present EU financing system could take either of two forms. It could be directed towards enlarging the fiscal base and developing new own resources for the Union or it could aim towards a simplification of present contributions arrangements. In the former case, the report notes that several candidates for ***new own resources*** exist but only one would be realistically available in the medium term. This is a modified VAT resource which, however, would not be entirely consistent with the equity criterion. Under the latter possibility, the present system of contributions could be replaced by a system where the VAT resource or even the so called Traditional Own Resources (TOR, i.e. essentially customs and agricultural duties) are replaced by contributions based on GNP. In this respect, Spain, supported by Greece and Portugal, has proposed the introduction of an element of ***progressivity*** into the system taking into greater account, albeit modified, each Member State's GNP. Although prima facie appealing, progressivity in contributions would not be consistent with the current acquis communautaire of practising solidarity through the expenditure side of the budget and promoting real convergence through investment.

Despite conceptual and technical difficulties linked to the relevance and measurement of budgetary (or net) balances, the issue of ***budgetary imbalances*** has re-emerged in the budget debate. Germany, the Netherlands, Austria and Sweden, have argued that their budgetary balances ought to be considered as excessive under the terms of the Fontainebleau agreement.

The report, as mandated by the 1994 Own Resources Decision, reviews the functioning of the existing ***correction mechanism in favour of the United Kingdom*** and of the budgetary imbalance of this Member State. The report notes that circumstances at the background of the UK rebate have undergone significant changes since the early and mid-1980s. The UK imbalance is no longer unique since several other Member States record similar imbalances. The relative prosperity of the United Kingdom after enlargement will be well above the average of the Union. While the Fontainebleau mechanism was essentially intended to provide a correction for the low share of the United Kingdom in agricultural expenditure, it currently confers it an advantage for all expenditure. Furthermore, if the mechanism were to remain unchanged, the United Kingdom would pay only one third of what it would otherwise pay for the forthcoming enlargement. Nevertheless, even after the rebate, the United Kingdom remains a larger net contributor than some Member States with higher capacity to pay.

The ***budgetary imbalances of Germany, the Netherlands, Austria and Sweden*** have become large in recent years reflecting, predictably, the impact of several factors. For the years to come, these imbalances, when measured in terms of GNP, are expected to change somewhat, under the influence of the forthcoming enlargement and the prospective reforms of expenditure policies and this would be more pronounced in the case of the Netherlands. Regarding enlargement, there will be an average deterioration in the budgetary balance of the present Member States of around 0.15 per cent of GNP, which should not give rise to demands for compensation. With regard to the reforms, it is not possible to estimate precisely their impact prior to the completion of the negotiations. However, it is likely that the reform of the Common Agricultural Policy will not affect significantly the budgetary balance of the Member States in question with the exception of the Netherlands where there is likely to be an accounting rather than a substantive effect. The impact of the reform of Structural policies on budgetary balances is even more difficult to estimate but, in any case, the reduction in Structural expenditure within the present 15 Member States will mean a reduction in contributions and a consequent relative improvement in the budgetary balances of these Member States even if Structural spending is concentrated in less prosperous regions.

If a political consensus on the need to address the issue of these imbalances were to develop, three courses of action would be possible. An option on the ***financing side*** of the budget would be to move towards an own resources system characterised by greater transparency, that is absence of ad hoc features, and equity, that is the removal of the remaining elements of regressivity. This would encompass the reduction or even the phasing out of the present correction mechanism, whose rationale would be weakened if an option on the expenditure side were to be adopted, and/or the partial or complete substitution of the GNP resource for the other resources were to be implemented.

Another approach, consistent with the Fontainebleau conclusions, would be to introduce corrections on the ***expenditure side*** of the budget. The report discusses an option involving the partial (75 per cent) reimbursement of CAP expenditure on direct aids to farmers. Without affecting either the Community nature of the CAP or the overall assistance to farmers - since the conditions attached to direct aids payments will continue to be an integral part of the Common Agricultural Policy and would result from EU decisions - the possibility exists to share between the EU and the national treasuries the amount of assistance in direct aids. This option would benefit those Member States where the share in financing is greater than the share in direct aids, but it would affect adversely those Member States where the opposite holds. Such an option would permit a reduction of the Agricultural Guideline and possibly of the own resources ceiling.

Finally, there is the option of a ***generalised correction mechanism***. A straightforward generalisation of the present mechanism to all Member States recording a negative budgetary balance would involve a huge increase in the redistribution of resources between Member States. However, it would be possible to modify some parameters of the present mechanism, for instance the threshold for compensation or the value of the compensation coefficient. This would generate many outcomes, some involving less, and others involving more, resources than the current UK rebate.

The report concludes by confirming the view put forward in *Agenda 2000*, that neither the need for an increase in the financial resources of the Union, nor the limited shortcomings of the financing system provide grounds to modify the Own Resources Decision at an early stage. The options presented in the report are interchangeable, can be completed and can be spread over time. However, none of these options provides an ideal solution. Technical and conceptual weaknesses can be found in all of them. The shifts in the burden of financing that results from some of these options present regressive elements that might need a redress in the context of an overall solution.

If a consensus were to emerge on the need to address the issue of budgetary imbalances, it would be necessary to choose between the options presented in the report or to agree on a combination of them which would respect their logic. The timing of any change would depend on whether a modification of the Own Resources Decision would be required, and enlargement would appear to present a change of circumstances so significant as to justify such a major structural reform.

EUROPEAN COMMISSION

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INTRODUCTION

The current Own Resources Decision foresees that the Commission will submit by the end of 1999 a report on the operation of the own resources system as well as on the correction of the budgetary imbalance granted to the United Kingdom. The Decision also requires that the Commission report on the feasibility of creating a new own resource as well as on the arrangements for the possible introduction of a fixed uniform rate levied on the VAT base[1].

The report has been prepared at a time when the EU is expected to widen its membership with the forthcoming enlargement and is in the process of considering significant policy reforms. Although difficult to quantify, the likely effects of enlargement and of the proposed reforms are also an important part of the report.

The first part of the report reviews and assesses the performance of the financing system of the European Union. A key argument developed in this part of the report is that the current system has performed adequately both in terms of sufficiency and in terms of equity in gross contributions. However, judged against the criteria of financial autonomy, cost effectiveness and transparency, the present system shows some shortcomings. The introduction of a new own resource is often seen as a way of improving the performance of the system. This part of the paper examines the case for and the difficulties in introducing a new own resource and of permanently fixing the rate of call of VAT. In addition, it reviews the recent proposal of Spain, Greece and Portugal to introduce a significant element of progressivity into the own resources system.

The combination of the present financing arrangements and of the expenditure decisions has resulted in budgetary imbalances which some Member States consider as too large. The second part of the report examines issues related to the budgetary positions of the Member States. In the current system, the sole Member State benefiting from a correction of its budgetary imbalance is the United Kingdom (also, Germany's share in the financing of the UK rebate is reduced by one third). Recently, other Member States have argued that they also meet the conditions mentioned in the Fontainebleau agreement as justifying the granting of budgetary relief. This section of the report comments on the budgetary imbalances of this group of Member States and presents some options for addressing the perceived difficulties.

1. THE PERFORMANCE OF THE OWN RESOURCES SYSTEM

The present part of the report extends over three sections. The first provides a description of the resource composition of the current system of own resources while its historical development is briefly summarised in Annex 1. The second section

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1 Article 10 of the Council Decision of 31 October 1994 on the system of the European Communities' own resources (94/728/EC, Euratom), *Official Journal of the European Communities* No. L 293/9, November 12, 1994.

provides an assessment of the present system according to the criteria of *adequacy, equity, financial autonomy, transparency/simplicity* and *cost effectiveness*. The third section addresses the issue of possible new own resources for the EU. Several potential new resources are considered while a detailed review of new own resources options is presented in Annex 2. Given the unequal tax base each potential resource represents in each of the Member States, this section also alludes to the possible conflict between increasing the financial autonomy of the EU and improving the equity of the system

1.1. The resource composition of the present system

The most recent modification of the system of own resources was agreed in the Edinburgh meeting of the European Council in December 1992. This political agreement was then transformed into a formal decision in October 1994[2] while the ratification by all national parliaments was finally obtained in the spring of 1996. The present system of own resources came into force, retroactively, on January 1, 1995.

Table 1

The composition of EU own resources

(as percent of total, accrual basis; data for 1998 and 1999 are projections)

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Traditional own resources	29.1	28.7	29.4	26.4	23.6	20.3	20.6	21.3	19.1	18.8	16.7	16.1
VAT [(1)]	60.0	60.7	69.9	59.5	61.9	54.0	51.9	57.8	51.3	45.5	39.7	35.4
GNP	10.9	10.6	0.7	14.1	14.5	25.7	27.5	20.9	29.6	35.7	43.6	48.4

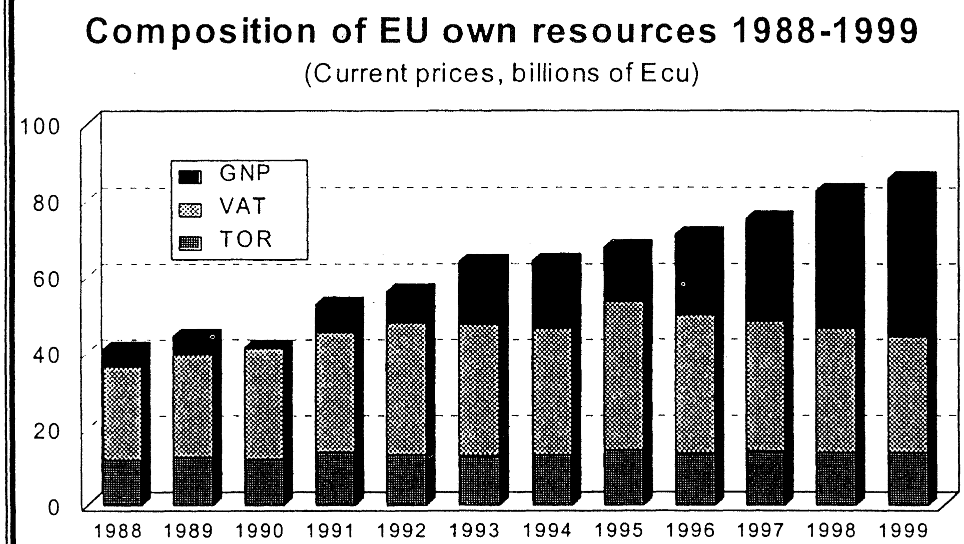
(1) Including the UK correction.

The changes introduced on this last occasion went in the same direction of those introduced in 1988 and have had significant implications for the composition of own resources. Table 1 presents the share of each category of resources in the budget, and graph 1 shows the absolute value of contributions by resource, over the period 1988-1999.

A notable feature of these data is, first, the trend decline in the relative contribution of the so called "traditional own resources" (TOR, customs and agricultural duties) whose share has fallen from 29.1 per cent of the total in 1988 to 19.1 per cent in 1996 and about 16 per cent in 1998-99. The impact of trade liberalisation on tariff levels has meant that the total yield of this resource has failed to increase in line with the expansion of world trade. In absolute terms, traditional own resources have remained in the range of Ecu 12 to 14 billion thus giving the observed reduction in the share of total resources.

2 Council Decision 94/728/EC, Euratom of October 31, 1994, footnote 1.

Graph 1



A second important development is represented by the decline in the share of VAT contributions from almost 70 per cent of total resources in 1990 to 51.3 per cent in 1996 and about 35 per cent in 1999. Correspondingly, the share of the GNP resource has risen to 35.7 per cent in 1997 and is projected to be close to 50 per cent in 1999.

The declining share of VAT revenues primarily reflects policy reforms introduced by the 1988 and 1994 Own Resources Decisions. In 1988 it had been agreed that the VAT base of the Member States should be limited to 55 per cent of their GNP. In 1994 it was decided to lower this limit to 50 per cent from 1995 onwards for the Member States whose GNP per head was below 90 per cent of the EU average (i. e. Greece, Ireland, Portugal and Spain) and to reduce progressively the capping of the VAT bases of the other Member States from 54 per cent in 1995 to 50 per cent in 1999. Table 2 records the capping threshold and the Member States whose VAT base has been capped over the period 1988-1999 as well as time series on the maximum and the uniform call rate for VAT.

In addition, in 1994 it was decided to lower, from 1995 onwards, the maximum call rate for VAT from 1.4 per cent to 1 per cent in 1999. However, the rate determining actual VAT contributions is the so called *uniform rate* which is lower than the maximum rate because of the need to leave aside an amount for the notional financing of the UK correction[3]. This rate has fluctuated between 1.20 and 1.28 per cent until 1994, but has since declined in line with the maximum rate and is projected to drop to 0.84 per cent in 1999 (see table 2).

3 See Annex 4 for a discussion of these issues.

The role of the GNP resource, introduced by the 1988 Decision, is one of a buffer serving a residual function to equate revenue and aggregate budget expenditure. As a consequence, the uniform call rate for GNP varies according to annual budgetary requirements; in 1995, for example, it was 0.339 per cent ; in 1997, it was 0.403 per cent; in the 1999 budget, it is estimated to be 0.534 per cent[4].

The budgetary balance from the previous year can affect resource availability in the current year and, correspondingly, the need to draw on the GNP resource. For example, the budget surplus of 1989 reduced GNP financing in 1990 to a minimum; in contrast, the slow growth in VAT revenues during the recession years of 1992-1994 made it necessary to increase residual GNP financing. In general, however, with the progressive decline in the share of revenues from traditional own resources as well as from VAT, the GNP resource is taking on an increasingly significant role in the financing of the EU budget.

Table 2

Capping threshold, Member States whose VAT base is capped, the maximum VAT call rate and the uniform VAT call rate

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998(1)	1999(1)
Capping threshold	55%	55%	55%	55%	55%	55%	55%					
Greece, Ireland, Portugal, Spain								50%	50%	50%	50%	50%
Other Member States								54%	53%	52%	51%	50%
Member States whose VAT base is capped	E, IRL, L	E, IRL, L, P, UK	IRL, P, UK	IRL, L, P	IRL, P	L	IRL, P	IRL, L, P	IRL, L, P	IRL, L, P	IRL, L, P, UK	GR, IRL, L, P, UK
Maximum VAT call rate	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.32	1.24	1.16	1.08	1.00
Uniform VAT call rate(2)	1.27	1.28	1.21	1.20	1.26	1.25	1.28	1.25	1.12	1.05	0.99	0.84

(1) Projections; (2) the difference between the "maximum VAT call rate" and the "uniform rate" depends on the size of the UK correction.

In addition to the resources mentioned in the previous paragraphs, the EU budget receives other revenues, which are not considered own resources, resulting from specific Community provisions. These revenues consist of fines, revenues accruing from the administrative operations of the Community institutions, contributions related to activities in the European Economic Area, interest on late payments, taxes on the salaries of employees of the European Institutions, income from borrowing and lending operations and other miscellaneous revenues. In 1997, such revenues amounted to Ecu 612 million or 0.74 per cent of all resources available to the budget.

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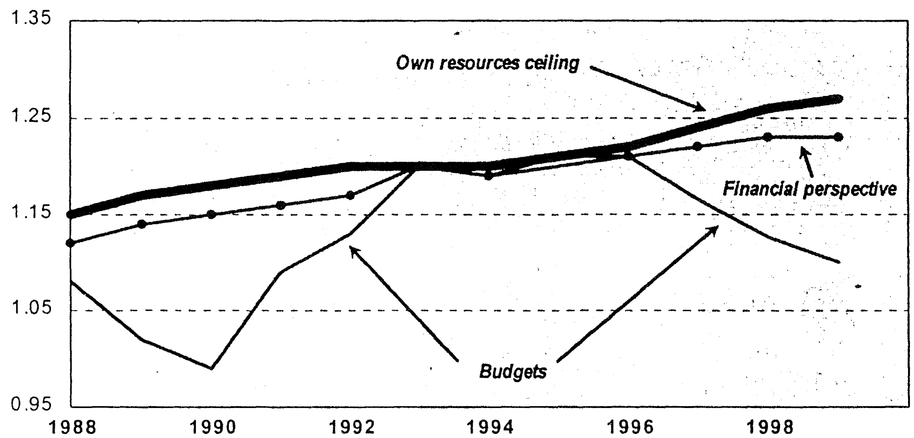
4 The 1995 and 1997 data refer to the Supplementary Amending Budget 1/95 and 1/97, respectively; the 1999 estimate is from the Preliminary Draft Budget 1999; the figures are rounded to three decimals while the actual budgetary calculations are performed using 15 decimals.

Graph 2

Own resources ceiling, financial perspective and budgets

(as a percentage of EU GNP)



1.2. An assessment of the present own resources system

The key criteria according to which the performance of the system can be evaluated are:

- *Resource adequacy*, i.e. the resource must have a significant yield relative to the size of the EU budget;
- *equity in gross contributions*, i.e. the burden should be fairly shared among Member States;
- *financial autonomy* i.e. the resource should increase the independence of the EU budget from national treasuries;
- *transparency and simplicity*, i.e. the determination of the tax should be easily understood by citizen; and
- *cost effectiveness*, i.e. the collection and administration costs of the resource should be low relative to its yield.

To anticipate the conclusions of this section, the present own resources system has performed satisfactorily when judged against the first two criteria, but some shortcomings are encountered with regard to the last three.

1.2.1. Adequacy and equity

The present own resources system has performed well against the criteria of adequacy of resources and equity in gross contributions.

Adequacy

The present own resources arrangements have generated sufficient revenue to finance expenditure plans. The decline of the traditional and VAT resources has been made up by the GNP resource. The previous own resources ceiling of 1.20 per cent of GNP proved barely adequate and difficulties were experienced, particularly during the recession of 1993. The recovery of 1994 and the accession of three new Member States in 1995 eased somewhat the constraints. More recently, however, the progressive increase in the own resources ceiling agreed in Edinburgh has gone hand in hand with greater restraint in spending decisions. As a result, a margin has appeared under both the Financial Perspective and the own resources ceiling which is expected to increase further in 1999 (see graph 2).

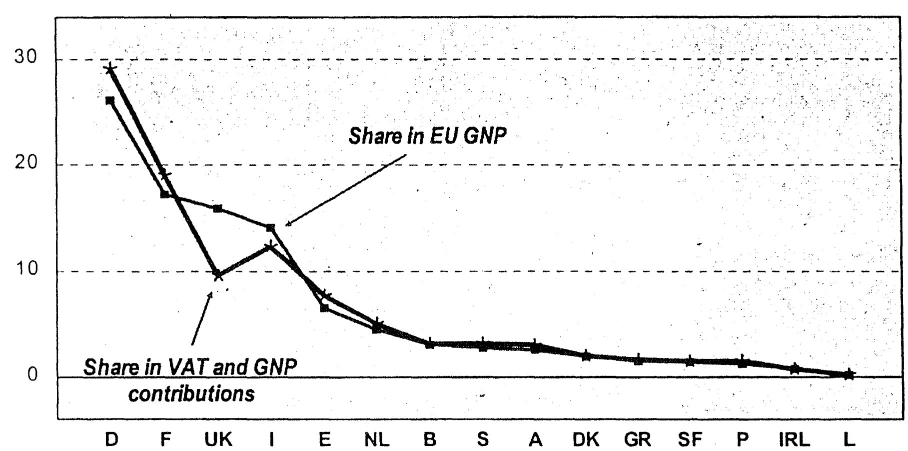
Equity

The equity of gross contributions of the Member States has improved, largely because of the progressive replacement of the VAT resource with the GNP resource. In this context, equity is interpreted to mean proportionality of gross contributions to income across the Member States[5].

Graph 3

Share in VAT and GNP contributions and share in EU GNP

(Data for 1997, in percent, after UK correction)



As a result of the 1988 Own Resources Decision, which opted for introducing the GNP resource rather than meeting financial needs through increasing the VAT call rate, and of the confirmation of this choice in 1994, Member States' contributions are now becoming more closely correlated with national GNPs[6]. As the ability to contribute to the EU budget can best be measured by a nation's national income

5 The issue of progressivity in the EU financing system is discussed in section 1.3.2 and in 1.3.4.

6 It is generally considered that the contributions on the VAT resource are regressive since they represent a higher proportion of GNP in poor rather than in rich Member States.

converted at current exchange rates into a common currency, the increasing importance of the GNP resource translates into improved equity in gross budget contributions.

Graph 3 presents data for shares in VAT and GNP financing, which is the part of the contributions that can be seen as coming directly from the Member States' treasuries, and shares in EU-15 GNP in 1997 for all Member States ranked in descending order, starting with Germany. The data confirm that contributions mirror closely GNP shares with the particular exception of Italy, and of the UK where the rebate has led to contributions that are considerably lower than the GNP share. Each year, however, the relationship between VAT and GNP contributions and GNP shares is influenced by several factors.

Table 3a

Member States' shares in EU financing and in EU-15 GNP

(in percent of total, data for 1997, including the UK correction)

B	DK	D	GR	E	F	IRL	I	L	NL	A	P	FIN	S	UK
Share in EU GNP														
3.1	1.9	26.0	1.5	6.6	17.2	0.8	14.2	0.2	4.5	2.6	1.2	1.4	2.7	16.1
Share in the financing of the EU budget														
3.9	2.0	28.2	1.6	7.1	17.5	0.9	11.5	0.2	6.4	2.8	1.4	1.4	3.1	11.9
of which : Traditional Own Resources														
7.4	*2.0*	*24.2*	*1.2*	*4.5*	*10.9*	*1.6*	*7.9*	*0.2*	*12.2*	*1.8*	*1.1*	*1.0*	*2.6*	*21.5*
of which : VAT and GNP contributions														
3.1	*2.0*	*29.1*	*1.7*	*7.8*	*19.0*	*0.8*	*12.4*	*0.2*	*5.1*	*3.0*	*1.5*	*1.5*	*3.2*	*9.6*

First, because all Member States pay an identical percentage of their VAT base and/or GNP, differences in the rates of growth of the VAT harmonised base (influenced largely by the growth of private consumption) and in that of GNP imply changes in relative shares and corresponding changes in relative contributions. Secondly, the corrections of the VAT and GNP contributions made once the outturn is known (i.e. in the year following that in which the contributions are paid) usually tend to amplify movements in contributions resulting from growth in the economy (when good economic growth is sustained for a number of years, the initial forecasts tend to be underestimated and therefore result in large supplementary payments when the correction is made and vice versa in the case of a downturn). As a result, trends in national contributions tend to show a cyclical pattern that is more pronounced than the economic cycle which influences its bases.

The inclusion of traditional own resources modifies somewhat the pattern of total contributions (see table 3a for the percentage shares and table 3b for absolute values). The share of Belgium, Ireland, the Netherlands and the UK in TOR is markedly higher than their shares in GNP, a reflection of substantial port facilities that serve as gateways of entry of foreign goods into the EU; studies suggest that this effect may be substantial. Its existence underscores one of the many difficulties involved in interpreting a simple difference between budget contributions and budget expenditure as a measure of the benefits a Member State enjoys from membership in the EU.

Table 3b

Difference between actual VAT contributions, TOR collection and theoretical GNP contributions

(Ecu million, data for 1997, excluding the UK correction)

B	DK	D	GR	E	F	IRL	I	L	NL	A	P	FIN	S	UK
Difference between VAT contributions and theoretical GNP ones (a minus sign means that the VAT contributions are lower than those to be paid under a system based only on GNP)														
- 266	- 71	708	20	98	159	8	-1 236	7	42	93	79	- 45	72	332
Difference between TOR collected in each country and theoretical GNP contributions (a minus sign means that TOR collected are lower than a contribution to be paid under a system based only on GNP)														
565	5	- 405	- 56	- 391	- 975	124	- 812	- 9	1 052	- 135	- 31	- 68	- 55	1 190
Sum of the previous two lines														
299	- 66	303	-36	- 292	-816	132	- 2 048	- 2	1 094	- 42	48	- 113	17	1 521

Additional advances towards improving equity in contributions will take place over the next years as the share of TOR and VAT in own resources will decline further. However, perfect equity cannot be expected since the VAT resource will continue to yield revenues which will not be correlated with national income and will continue to introduce an element, albeit small, of regressivity into the system. In addition, equity in gross contributions is hindered by the presence of the UK rebate mechanism, which reduces their correlation with the ability to pay.

1.2.2. Financial autonomy, cost effectiveness, transparency and simplicity

In certain respects, the present system shows shortcomings in terms of financial autonomy, cost effectiveness and transparency. To a large extent, this is due to the fact that there are inevitable trade-offs between financial autonomy, equity and cost effectiveness. The dominant part of EU resources derives from national contributions from the treasuries of the Member States; this reduces the financial autonomy of the EU, but offers a good degree of equity and of cost effectiveness. Traditional own resources contribute to financial autonomy, but their equity is contested and their collection and control are very cumbersome.

Financial autonomy

Traditional own resources represent currently the only true own resource of the EU. However, the importance of TORs in financing EU expenditure is diminishing markedly. Moreover, although customs duties and related revenues resulting from the EU's commercial policy formally belong to the EU, Member States that collect these duties tend to regard them as national contributions. This is not appropriate and it reduces further the significance of budgetary balances[7].

The lack of financial autonomy resulting from the low share of real own resources in the financing of the budget is considered responsible for various shortcomings of the present system.

- *First*, it has made the EU increasingly dependent on intergovernmental transfers; such dependence has already contributed to conflicts and has encouraged Member States to seek to maximise ill-defined concepts of the national benefit from the EU budget;
- *second*, the system whereby all financing needs not covered by TOR or the VAT resource are covered by the GNP resource is very cost effective, but it results in changes in EU expenditure at the margin being reflected in changes in national spending. This entangles EU financing issues with domestic financial and budgetary policies at the expense of revealing to the citizens the EU-wide priorities at stake; and
- *third*, democratic accountability is obscured because of lack of a direct relationship between citizens and taxes paid to the EU budget.

Cost effectiveness

The collection of traditional own resources is very cumbersome and the attitude of Member States towards these resources is ambiguous. Customs legislation is very elaborate with over eleven thousand tariff positions and a Community customs code of about 400 articles[8]. However, international trade is a much more complex reality with new products and new trade flows appearing every day. Under these conditions, there is scope for fraud, irregularities and litigation.

In the present institutional system, Member States are responsible for collecting traditional own resources and putting them at the disposal of the Commission. The latter has the responsibility to control the way Member States perform this task. To this end a complicated machinery has been set up which amounts to a form of *multilateral surveillance* of the way in which Member States carry out their duties. Any loss in the collection of TOR in a Member State must be made up by a corresponding increase in the GNP resource called. As a result, the negligence of a Member State has financial consequences for all the others. For this reason, the results of the control activities of the Commission are made available to all Member States[9] and all important decisions on the non recovery or remission of customs duties as well as on the write-off of amounts impossible to collect are taken with some involvement of all Member States.

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[7] For a discussion of the concept and measurement of budgetary balances see Annex 3.

[8] There are, in addition, over 900 articles of the Regulation laying down the provisions for its implementation.

[9] This provision also applies to the controls on the VAT and GNP resources.

These provisions result in a substantial amount of administrative work which, as the reports of the Court of Auditors show year after year, always falls short of what would be desirable for a better protection of the financial interests of the EU. In addition, the complexity of the procedures for the recovery of amounts put at risk by fraud or irregularities appears to discourage most national administrations, which often appear unable or unwilling to recover what is due.

Under these conditions, Member States appear to prefer to finance the EU budget through GNP instead of through a more effective collection of TOR even if this must have implications for the distribution of the financial burden. In effect, they are neither inclined, for understandable reasons, to tighten the regulatory framework of the customs system nor do they appear willing to commit the necessary resources to the collection of customs duties.

Transparency and simplicity

With four Member States having their VAT base capped in 1998 (as, probably, will be the case for all the future new Member States), the VAT resource is becoming in effect a GNP resource. In its 1998 report on the functioning of the VAT and GNP resources, the Court of Auditors points out that the VAT resource, despite being formally a tax on consumption, has taken the character of a financial contribution from Member States to the EU budget with its determination depending to a certain extent on statistical calculations (especially for the estimation of the weighted average rate).

The presence of the UK rebate contributes to obscuring the exact nature of the system and its consequences. Not only, as already indicated previously, does it reduce the correlation between gross contributions and ability to pay, but its calculation and financing arrangements are so complex as to impair the transparency of this mechanism.

1.3. Options for a new system of contributions

Modifications of the present system of contributions could either make it simpler through a reduction in the number of sources of financing or could introduce new own resources in addition to the existing ones or as a replacement of some of them. The arguments in favour of a simplification of the present system of contributions are essentially based on the shortcomings of the present own resources system in terms of financial autonomy, cost effectiveness and transparency discussed earlier. The introduction of new own resources is sought as a way of improving financial autonomy.

New fiscal own resources would clearly reduce the share of the EU budget financed through national contributions and would ease the tensions arising from attempts to measure net contributions. Should the budget be fully financed through own resources, the link between changes in EU expenditure and corresponding changes in national expenditure would also be broken. As well, if the EU budget were to become entirely financed through "real" own resources whose rates of call were to be decided every year, the budgetary authority would have full control of the expenditure and of the revenue side of the budget. Finally, proponents of new own resources expect them to enhance political accountability, transparency and visibility to citizens. However, because the distribution of the tax bases for fiscal resources are not equal across the Member States, introducing a new own resource and, thus, enhancing financial autonomy, could be in conflict with enhancing equity in contributions.

1.3.1. Simplification of the present system of contributions

The yield from TOR is low and will decline further while their administration is very cumbersome. The frustration felt with TOR is such that proposals have been made to return them to the Member States. While admitting that TOR should theoretically be attributed to the central level, it is sometimes considered that their relative share in the total financing of the EU is so low that returning them to the Member States would yield practical advantages compensating for the implicit sub-optimality of such attribution. The distributional problems that are likely to appear could be partly reduced through measures aimed at encouraging the use of the transit facility that allows the payment of customs duties where the goods are finally consumed. It is clear that even if customs duties ceased to be own resources of the EU budget, they would continue to represent an important instrument of the Union's trade policy and their effective collection would require some form of control by the Commission on behalf of the Member States.

The present VAT-based own resource has drawbacks with respect to equity in contributions, financial autonomy and transparency. As the Court of Auditors has recently underlined again, it is hardly an own resource given the way in which its base is calculated and the existence of rules which, for some Member States, make it effectively a GNP based resource. In addition, its uniform rate of call varies every year according to the size of the UK rebate. This is due to a provision that calls for the UK rebate to be notionally financed through VAT and therefore reduces further, by a variable amount, the maximum rate of call.

If on the occasion of a future modification of the Own Resources Decision the VAT-based resource were maintained, it would at least appear necessary to call it at a fixed rate. This could be achieved through putting an end to the presumption of financing the UK rebate on the VAT resources accompanied by a corresponding permanent lowering of the maximum rate of call[10].

Own resources almost always entail significant collection and control costs and are therefore less cost effective than straightforward national contributions. In addition, no own resource can be more equitable - in the sense of being linked to the ability to pay - than a contribution based on GNP which constitutes the best available proxy of such ability to pay. Indeed, some proposals for new own resources include parallel

10 On average, over recent years this provision has lowered the rate of call of VAT by 0.12 percentage points - see Annex 4.

corrections in the form of an equalisation mechanism intended to align gross contributions to GNP shares.

A further consideration in this context is that taxes influence the allocation of resources and there is some merit in having a system of national contributions and leaving it to the Member States to decide on the best way to raise the corresponding financial resources. These considerations have prompted proposals for the replacement of the present system of own resources with a system based solely on GNP contributions, which would provide no financial autonomy whatsoever, but that would be equitable, transparent and cost effective.

Whatever the future of such a proposal, it must be underlined that the present GNP-based contributions suffer from the unwillingness of Member States to use the best available data for the reference aggregate. Estimating the total value of the national income of a country is a difficult task. In particular, the methods used must evolve in line with the transformations of the economies to take into account the changes in the goods and services produced and delivered. To this end, the national statistical offices of the European Union have recently developed a new common methodology to estimate GNP[11] and new decisions are taken periodically to update and refine it (a recent important one was taken at the end of 1997 and concerned the imputation of financial services indirectly measured). However, Member States have sought to delay the use of these new measures in the EU budget[12] thus leading to the co-existence of two statistical series for GNP: one, of better quality, for general use and another, less reliable, used for the assessment of the GNP contributions. If GNP will continue to play a role in the system of own resources, this situation must be corrected with any GNP contributions based on the most recent and most reliable definitions.

1.3.2. Criteria for new own resources

A set of criteria, some of which derive from economic rules regarding the assignment of policy instruments to different levels of jurisdiction (Member State or EU) while others are more specific to the EU, can be used to select candidates for new own resources[13]. Economic theory predicts that tax instruments belong optimally to a

11 European System of Accounts (ESA) 1995, Council Regulation 2223/96 of June 25, 1996, *Official Journal of the European Communities* L310, November 30, 1996.

12 The use of the figures resulting from the new system of national accounts will have to wait until the adoption of a new Own Resources Decision while those taking into account the indirectly measured financial services will need an ad hoc decision by the Council.

13 For a review of these issues see Commission of the European Communities (1993): "Stable Money - Sound Finances Community Public Finance in the Perspective of EMU", *European Economy* no. 53, especially ch. 7; see also Annex 2. These criteria obviously do not apply in the case of a tax introduced throughout the EU as instrument for the implementation of a Community policy. In this case, the rationale for the introduction of the tax would derive from the specific policy in question and the attribution of its yield to the EU budget would only have to respect the criterion of cost effectiveness.

higher level of authority when there are cross-border externalities and/or when it is difficult to attribute specific revenues to specific Member States.

In the case of the EU, additional specific criteria are appropriate. A very important one is that contributions ought to respect *horizontal equity* so that among Member States of equal ability to contribute all do indeed contribute an identical amount. However, given that the level of real income is not equal among the Member States, it is sometimes felt desirable that *vertical equity* be satisfied as well, so that contributions to the EU budget are a function of the Member States' differential ability to pay. Recently Spain, supported by Greece and Portugal, has proposed the introduction of a significant element of progressivity into the contributions to the EU budget.

It is also necessary that new own resources be consistent with other EU policies so as not to offset their effects. Their visibility for the EU citizens is also desirable while, on a more technical level, their base must present a sufficient degree of harmonisation and their collection should be possible without too high administrative costs. Finally, their yield must be high enough to finance a substantial amount of EU spending.

1.3.3. Possible future own resources

The search for new own resources has so far proved elusive. This has been partly due to the generally good performance of the present system, which has blunted incentives for finding new resources, but principally to the difficulties involved in establishing new own resources and also to differing political priorities. Since 1992, however, interest in establishing new own resources has increased, in part reflecting institutional initiatives and in part related to emerging new possibilities[14]. The publication of a report by the European Parliament on new own resources, advocating a modulated VAT-based system[15], is important in this context.

A ***modified VAT resource*** offers the potential of becoming an important own resource in the future. Such a tax would be highly visible to taxpayers and would be consistent with the establishment of EU-wide minimum tax rules and would also generate sufficient revenues for the budget. However, VAT is levied on a national tax base and it is difficult to see its revenues as belonging to the EU, and also it may entail considerable administration costs.

A European Parliament (1994) report[16] advocated a new own resource based on a common VAT call rate across the Member States, differentiated across commodities according to two rates, a lower one and a higher one, of say 1.5 per cent and 3 per cent. The tax would be levied on a harmonised base through declarations explicitly recording that it is an EU tax. Total VAT revenues would be divided between the

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14 Annex 2 reviews in detail eight specific proposals for new own resources.

15 See European Parliament (1994): "Draft Report on a New System of Own Resources for the European Union", Rapporteur Horst Langes, Committee of Budgets, A3-0000/94.

16 See European Parliament (1994): op. cit., footnote 15.

national budget and the EU, and national parliaments would determine the part for domestic budgetary purposes while the EU budgetary authority would determine the part to be attributed to the Community budget.

The proposal could be implemented. It would clearly involve a number of technical problems, but these could be overcome if there was the political will to proceed in this direction. It is questionable, however, if such a system should be accompanied, as in the European Parliament proposal, by an equalisation mechanism ensuring that national contributions would be proportional to each Member State's share in the GNP of the Union[17]. If the idea is to tax the consumption of individuals, then the concept of national contributions should not enter into the equation.

Other possible own resources – a form of withholding tax, a CO_2/energy tax, excise taxes, seigniorage, corporate and personal income taxes, new communication taxes – are discussed in the Annex *"Review of possible new own resources for the European Union"* (Annex 2). At this stage, it is important to note that, despite proposals made for new own resources, there is little consensus about which one(s) would be the most appropriate. This is a reflection of differences of views regarding the future orientation of European integration.

1.3.4. Progressivity in contributions

A proposal to introduce progressivity in the system of own resources has been made by Spain. The proposal, which is supported by Greece and Portugal, is founded on the Protocol on Economic and Social Cohesion, in particular, on the declaration of intent of the high contracting parties to take *"greater account of the contributive capacity of individual Member States in the system of own resources, and of examining means of correcting, for the less prosperous Member States, regressive elements existing in the present own resources system"*. It should be stressed at this stage that, during the 1992 discussions of the 1993-1999 Financial Perspective, equity was understood to mean proportionality with GNP and, as noted in section 1.2, measures have already been taken to address the regressive elements of the own resources system. The proposal recognises that improvements, related to the increasing importance of the GNP resource, have been made but it also underlines that progressivity in contributions continues to be absent from the own resources system.

Greater progressivity in contributions could be achieved, according to the proposal, by adjusting the base of the GNP resource through the use of coefficients reflecting each Member State's relative prosperity. The adjustment can be complete (applying to the GNP resource) or partial (applying to only part of the GNP resource), and in the latter case progressivity would also be partial. Member States could also be grouped into classes of relative prosperity (for example, Member States with income per capita less than 90 per cent of the EU average, those between 90 per cent and 100

17 See Annex 2 for a more detailed discussion of this proposal.

per cent, etc) with specific adjustment coefficients assigned to each class. Contributions to the EU budget would then be determined according to the new bases. The new resource could ultimately, it is argued, replace the VAT resource.

Table 4

Modifications of total national contributions relative to the present system
Progressivity proposal applied to the GNP resource

(adaptation of the GNP base using the ECU index of GNP per head; the percentages indicate changes relative to present total contributions)

	1996		1997	
	Ecu million	%	Ecu million	%
B	75.9	2.7	70.0	2.3
DK	134.9	9.6	178.6	11.6
D	1105.6	5.2	1043.4	4.8
GR	-155.4	-13.8	-204.1	-17.1
E	-551.1	-11.9	-803.9	-14.8
F	311.0	2.5	259.1	1.9
IRL	-45.4	-6.5	-45.4	-6.4
I	-404.0	-4.4	-466.4	-5.3
L	38.2	23.5	47.9	27.7
NL	55.3	1.2	44.5	0.9
A	102.3	5.4	102.0	4.8
P	-152.2	-17.6	-199.3	-18.2
FIN (1)	-6.7	-0.7	1.3	0.1
S	67.9	3.4	71.1	3.0
UK (1)	-576.2	-6.8	-98.9	-1.1
Total	**0.0**		**0.0**	

1) The technicalities of the proposal result in these countries marginally benefiting from the operation of the progressivity mechanism even if their index of GNP per head is slightly above 100 (see Annex 7)

It should be noted at the outset that the proposal does not entail the introduction of a new own resource as such but it provides for a significant modification of an existing resource (GNP). A simulation of the impact of the proposal on the budget contributions in 1996 and 1997 is presented in table 4.

The proposal is prima facie appealing since progressivity is found in virtually all the Member States' national tax systems. However, the proposal has an important drawback in that it does not acknowledge the nature of solidarity and its practice in the Community. There are two main reasons for the current EU choice of implementing solidarity through the expenditure side of the budget[18].

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18 The arguments are developed in greater detail in Annex 7.

- *First*, solidarity in the EU is mainly expressed in the form of improving real convergence by directing funds mainly to eligible regions in any Member State rather than to a Member State as a whole.

- *Second,* achieving real convergence has a higher probability under expenditure-based progressivity than under progressivity in contributions. The reason for this is that progressivity in contributions, by lowering the financing shares of the less prosperous Member States, would leave it up to them to use the funds as they see appropriate. It is plausible to expect that, in this case, investment activity would not be strengthened as much as under expenditure-based progressivity.

2. THE ISSUE OF BUDGETARY IMBALANCES

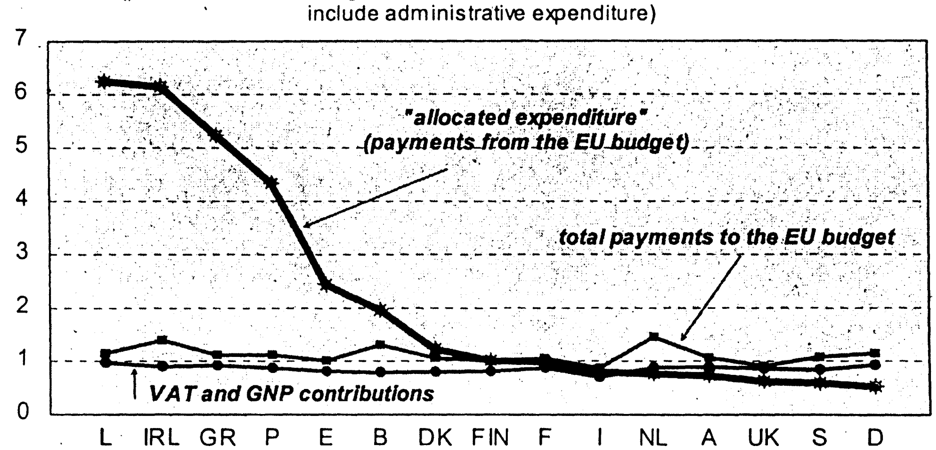
Budgetary balances (also called net balances), measured by the simple difference between contributions to and receipts from the EU budget, represent only a narrow view of, and fail to fully account for, the benefits accruing to Member States from participating in the EU[19].

Recorded budgetary flows fail to account for positive externalities arising from EU policies. For example, CAP, structural operations and external expenditure benefit not only the immediate recipients but also give rise to spill-over effects transcending national borders[20]. It is clear that their consideration would modify the assessment of the accounting imbalances even if it is not possible to quantify the importance of these spill-overs.

Graph 4a

Total allocated expenditure, VAT and GNP contributions (before UK correction) and total payments to the EU budget

(percent of GNP; average 1995-1997; the data for "allocated expenditure" include administrative expenditure)



There are also difficulties associated with the identification of the ultimate beneficiaries of EU expenditure policies; for instance, CAP export restitutions do not necessarily benefit the residents of the country where they are paid. In addition, EU budget expenditure is heterogeneous and comparisons of total amounts received have often limited meaning in appreciating the "benefit" resulting from such payments: a given amount spent in purchasing goods and services does not bring the same advantages of the transfer of a grant of an equivalent amount. Similar problems

19 See Annex 3 for a discussion.

20 These spill-over effects include the spending of income generated in the receiving Member State on goods produced in another Member State, the purchase of financial asset denominated in various Member States currencies etc.

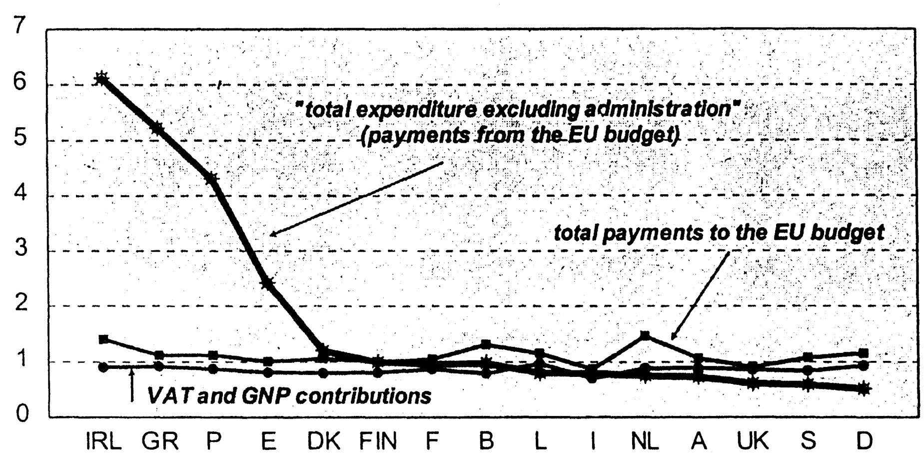
appear on the revenue side: the country where customs duties are collected is not necessarily the one of residence of the economic agents ultimately bearing their burden.

The definition of budgetary balances is also fraught with significant conceptual and accounting problems. To compute budgetary balances it is necessary to make numerous choices on the items to be included in the receipts and expenditure flows as well as on the reference periods (e.g. cash vs. accrual figures, surpluses from previous years, etc.). Depending on the choices made, it is possible to obtain numerous, equally valid, definitions of budgetary balances which sometimes produce significantly different results[21].

Graph 4b

EU expenditure (excluding administration), VAT and GNP contribution (before UK correction) and total payments to the EU budget

(percent of GNP; average 1995-1997)



Nevertheless, the size of some of these imbalances has been at the centre of discussions for many years[22]. In response, a compromise was struck in 1984 at the

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21 See Annex 3 and Commission of the European Communities (1997): "Budget Contributions, EU Expenditure, Budgetary Balances and Relative Prosperity of the Member States", paper presented by President Santer to the Ecofin Council, October 13. The two definitions used in this report are the *UK rebate* definition (concept used in the calculation of the UK rebate) and the *operational* definition (difference between all moneys paid to and all moneys received from the budget excluding administrative expenditure and expenditure related to other EU institutions).

22 The largest imbalances, although substantial in absolute terms, measured as a percentage of the GNP, are much smaller than the regional budgetary positions existing within Member States. A recent study conducted under contract for DG XIX indicates that, using a definition of regional budgetary positions comparable to that commonly used in the relationships between Member States and the EU budget, the average negative budgetary position of a region of northern Italy is equal to almost 4 per cent of its GDP, while the average positive balance of a southern Italian

Fontainebleau meeting of the European Council. According to the conclusions of that meeting,

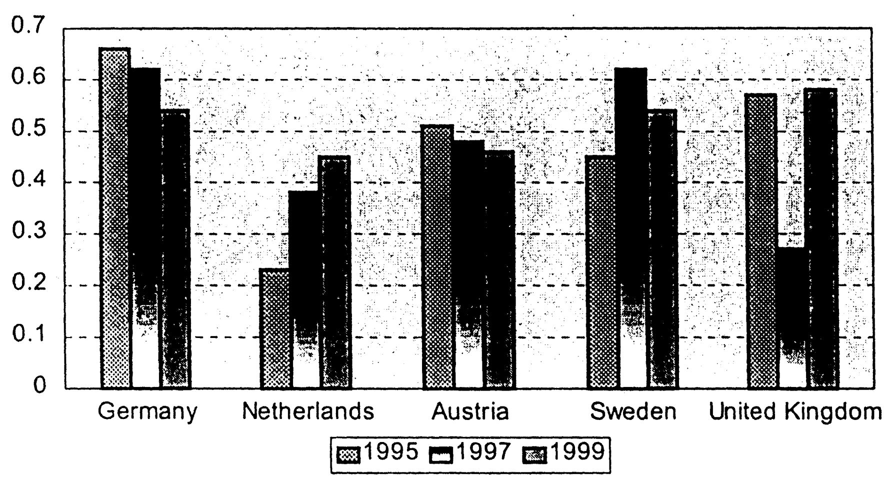
> "Expenditure policy is ultimately the essential means of resolving the question of budgetary imbalances.
>
> However, it has been decided that any Member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time." [23]

The reference to expenditure policy as the means of correcting budgetary imbalances reflects the prominent role that expenditure decisions have in their determination (see graphs 4a and 4b). Correcting budgetary imbalances through ad hoc mechanisms essentially amounts to a refusal to act directly on the sources of the imbalances.

Graph 5

Negative balances of some Member States

("UK rebate" definition; percentages of GNP; United Kingdom before correction)



In the present part of the report, the first section reviews the performance of the correction mechanism in favour of the United Kingdom set up following these decisions. In March 1998, four Member States, namely Germany, the Netherlands, Austria and Sweden have stated their belief that their negative balances are to be seen as excessive in relation to their prosperity under the terms of the Fontainebleau agreement. The second section of the report examines the development of the balances of these Member States.

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region is equal to around 7 per cent; see G. Pola (1998): "The Regional Incidence of a Central Budget – The Italian Case".

23 See Fontainebleau European Council, Conclusions of the Presidency, Bulletin of the European Communities 6-1984.

The third section provides some indications of the possible effects of the Agenda 2000 reforms on the budgetary imbalances of the five countries examined in the previous two sections. Finally, the fourth section reviews some of the main options available in relation to the issue of budgetary imbalances: phasing out of the correction mechanism for the United Kingdom, corrections on the expenditure side of the budget and application of a correction mechanism to all Member States experiencing large imbalances.

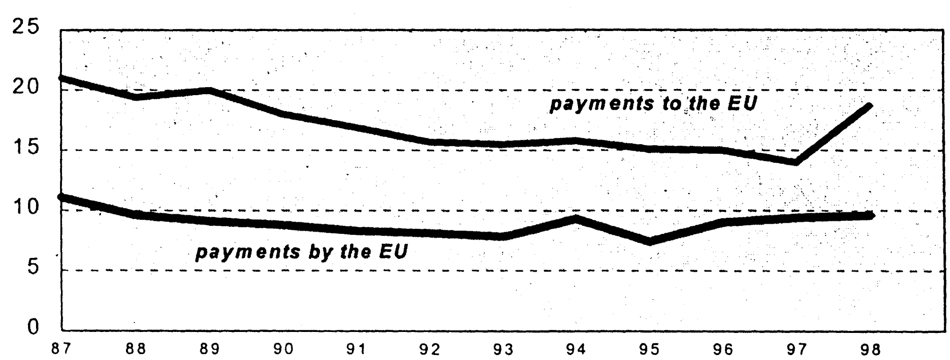
2.1. The UK budgetary imbalance[24]

The budgetary imbalance of the United Kingdom was at the centre of the political debate for about a decade (1974-1984) provoking frequently stalemates in the EU decision-making process. The question was finally settled at the Fontainebleau European Council of 1984 and the resulting rebate mechanism constitutes an integral part of the Own Resources Decisions taken subsequently. The rebate was reviewed in 1988 and 1992 and on both occasions the European Council decided that it should be continued.

Graph 6

Share of the United Kingdom in (VAT and GNP) payments and in EU (allocated) expenditure

(percentage of totals; accruals figures; 1995-97: provisional figures; 1998: forecasts)



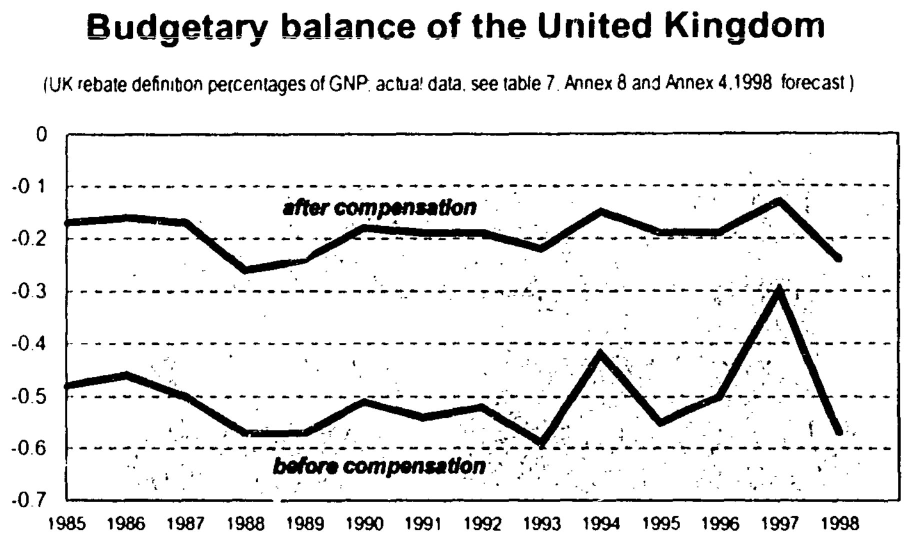
The size of the budgetary imbalance of the United Kingdom - and therefore that of its compensation - has fluctuated substantially since 1985 around half a point of GNP for the imbalance and 0.3 per cent of GNP for the rebate[25]. Graph 6 shows developments in the shares of the United Kingdom in payments to the EU budget and in EU expenditure over the period 1987-1998.

[24] For more details on the functioning of the UK rebate, see Annex 4.

[25] See Annex 4 for a more detailed analysis of the evolution of the UK rebate and an explanation of its variability.

Graph 7 shows that the mechanism has been effective in reducing substantially the negative balance of the United Kingdom. However, even after the rebate the United Kingdom remains a larger net contributor to the EU budget than Member States with a higher capacity to pay.

Graph 7



Some of the conditions that prevailed at the time the mechanism was decided do not apply any more:

i) Changes in the composition of EU spending have modified the rationale of the compensation. Whereas in 1984, it had essentially the nature of a correction for the specific agricultural problem (CAP represented about 70 per cent of total allocated expenditure), it has now lost to a great extent this characteristic since it corrects equally the agricultural problem as well as the United Kingdom's contribution to the solidarity effort of the EU and to its other policies. If a correction on the expenditure side of the type presented in section 2.4.2 (partial reimbursement of CAP direct aids) were to be introduced, this consideration would become even more relevant.

ii) The budgetary imbalance of the United Kingdom is no longer unique. In 1984, the imbalance of the United Kingdom, before correction, was the largest of the Community. In recent years, four more countries have budgetary imbalances as large as the United Kingdom's (see graph 8).

iii) The gap in relative prosperity between the United Kingdom and some other large contributors to the EU budget has narrowed. The United Kingdom has a relative prosperity (and a corresponding relative capacity to pay) around the EU average and will certainly be above this mark after the forthcoming enlargement of the EU[26].

The mechanism also has some technical drawbacks and a more fundamental, systemic, characteristic which, although not new or unexpected, ought to be underlined.

With respect to the technical drawbacks,

- the existence of the rebate leads to budget contribution by the United Kingdom representing a lower proportion of its income than those paid by the other Member States and therefore creates a distortion in the system of contributions;

- the definition of the EU expenditure to be used in the calculation of the compensation ("allocated expenditure") includes also administrative expenditure whose nature is substantially different from the rest of EU spending and whose inclusion in any calculation of the budgetary imbalances has often been questioned[27]; and

- allocated expenditure is defined in a way which may provoke a small, but quite unjustified, increase in the rebate at the time of enlargement. With enlargement, some expenditure flows directed to the new Member States (e.g. PHARE), which are currently considered "external expenditure" and therefore do not enter into the calculation of the rebate, will be replaced by payments under internal policies which enter into the calculation.

The systemic characteristic of the rebate mechanism, on the other hand, is its function as a shock absorber for all changes in the imbalance of the United Kingdom; this would place this country in a unique position in respect to common budgetary decisions. This not only risks insulating the United Kingdom from the implications of budgetary decision-making but would have significant adverse effects at the time of enlargement. The accession of a large number of new Member States with very low standards of living is expected to have a negative effect on the budgetary positions of the current Member States. But the United Kingdom will see its budgetary position deteriorate by only one third of what would have happened in the

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26 International comparisons of income are made by comparing the levels of GNP per head of different countries. These comparisons need a common numeraire which is usually arrived at through the use of current exchange rates or especially computed conversions rates – the so called "purchasing power parities" (PPP) – which take into account the differences in the price levels. Data based on current exchange rates provide a measure of actual income and are therefore the best proxy for the ability to pay. Data based on PPP estimates measure the real income of the average citizen of a country when he/she spends it in his country. The Fontainebleau agreement does not specify the measure to be used. The EU uses both measures. PPP data are used in identifying "objective 1" regions and the beneficiaries of the Cohesion Fund; current exchange rates are used in the calculations of budgetary contributions and in the identification of the countries benefiting from the lower level of capping of their VAT bases.

27 For this and other difficulties in defining budgetary imbalances see Annex 3.

absence of the correction mechanism, which would put into question an equitable sharing out of the burden resulting from enlargement.

The provisions for the calculation and for the financing of the rebate are extremely complicated and inhibit budgetary transparency and accountability. In any case, it would be necessary to at least simplify the financing provisions and ensure that the VAT rate of call will not depend any more on the size of the rebate (see paragraph 1.3.1).

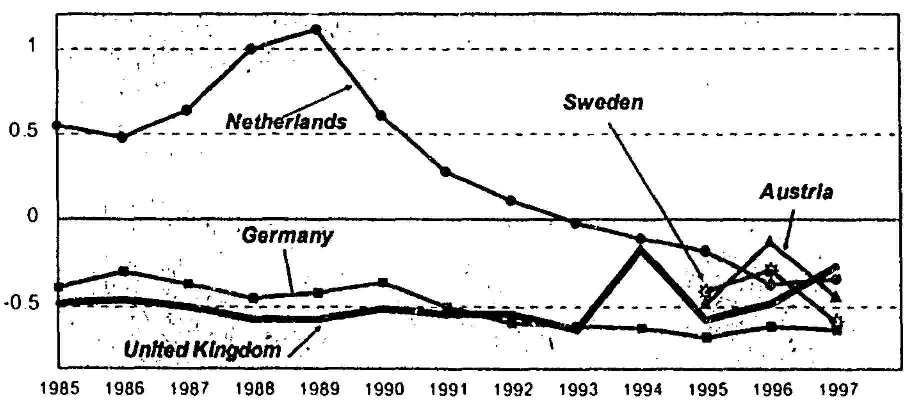
2.2. The budgetary imbalances of Germany, the Netherlands, Austria and Sweden

Germany, the Netherlands, Austria, and Sweden have recently indicated that they consider their negative budgetary positions as excessive "relative to their prosperity" and, therefore, as candidates for a correction under the Fontainebleau agreement. In addition, these countries underlined their dissatisfaction with the present situation where other Member States of similar capacity to contribute to the EU budget show much smaller negative balances or even positive ones. Graph 8 confirms that these four countries do indeed record significant budgetary imbalances.

Graph 8

Budgetary balances of the UK, Germany, the Netherlands, Austria and Sweden

(*UK rebate definition*; *before UK rebate*; percentages of GNP)



The Fontainebleau agreement established that to benefit from a correction mechanism a Member State's budgetary burden must be excessive in relation to its relative prosperity[28]. *Relative prosperity* is used to determine how well off are the citizens of a country or of a region compared to the EU average and is expressed in Purchasing Power Standards (PPS) data. Subsequently, the Protocol on Economic and Social

[28] See footnote 26 and Annex 4.

Cohesion established that the proper way to take greater account of the Member States' *relative prosperity in the system of own resources* is by considering their *contributive capacity.* A Member State's *contributive capacity* can be used to determine its (citizens') capacity to contribute to a given international expenditure and is measured by converting nominal incomes into a common numeraire using current exchange rates, since the latter constitute the terms in which a country's income purchases international goods and services, including EU budget contributions[29].

Over the last decade, substantial changes in the relative position of the four Member States, measured by either concept, have taken place and these have been particularly pronounced in the cases of Germany and Sweden (see table 5, and tables 8 and 9 of the Statistical Annex 8).

Table 5

Capacity to pay and relative prosperity

Gross national product at current market prices per head of population in Ecu and in PPS
(until 1990: D and EUR-15 exclude East Germany; from 1991: D and EUR-15 include the new Länder)

	ECU					PPS[1]				
	1984	**1990**	**1991**	**1995**	**1997**	**1984**	**1990**	**1991**	**1995**	**1997**
B	101.0	104.0	106.0	121.5	112.8	106.8	105.3	109.2	115.7	115.3
DK	131.1	127.8	124.3	140.2	137.4	106.7	100.6	102.4	110.8	112.5
D	129.9	127.3	114.6	130.9	118.6	119.0	117.8	107.3	110.4	109.4
GR	53.5	44.0	46.6	49.2	53.3	62.8	59.3	62.3	66.5	69.0
E	52.3	66.7	71.4	63.4	62.6	69.0	74.2	79.4	76.8	77.7
F	115.7	111.4	110.3	116.4	109.9	111.7	109.7	113.0	106.7	104.3
IRL	61.9	61.3	62.4	69.1	79.9	59.6	64.3	68.7	80.5	82.4
I	92.7	101.1	105.3	83.2	92.2	101.9	101.9	105.5	103.7	102.6
L	171.4	184.0	192.3	201.8	186.4	173.5	185.2	196.6	181.6	176.2
NL	112.0	100.7	101.2	113.7	108.1	102.7	101.3	102.3	106.8	106.0
A	109.3	109.2	111.8	127.6	118.8	106.1	105.8	108.8	111.1	112.6
P	26.2	35.8	41.5	46.8	46.7	49.4	58.9	64.5	70.0	69.6
FIN	130.1	139.5	123.3	105.9	104.9	99.1	99.9	91.1	93.6	96.4
S	144.5	137.8	142.4	111.7	114.2	111.8	104.5	102.4	97.3	93.7
UK	98.6	89.1	91.2	83.8	101.8	99.6	99.5	96.3	96.4	100.3
EUR-15	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

1) PPS = Purchasing Power Standards

29 See footnote 26.

The origins of the imbalances of these four countries, however, are different. Germany has had a large negative budgetary position for many years. As a wealthy country with a relatively small agricultural sector it attracts low shares of Structural Funds and CAP spending. The German negative balance deteriorated further between 1990 and 1995 for various reasons. In 1990 and 1991, the country experienced a rate of economic growth much higher than those of the other Member States which led to an increase in its relative share in GNP and in the financing of the Community. After unification the country started receiving significant payments in favour of the new Länder under the Structural Funds, but this was more than compensated by the progressive increase in Structural Funds spending decided in Edinburgh in 1992 and by their concentration in the so called "cohesion" countries. Since 1995, the negative budgetary position of Germany has remained essentially stable. These developments have been largely consistent with the projections made at the time the 1988 Own Resources Decision was modified. In fact, had EU expenditure increased by as much as the current Financial Perspective would have allowed the negative budgetary balance of Germany would have been larger[30].

Table 6

Budgetary balances of some Member States in 1999 and worst and best performance in the 1995-97 period

(percentage of GNP; UK before correction)

	Germany	Netherlands	Austria	Sweden	UK
	Operational balances				
worst	-0.72	-0.76	-0.49	-0.59	-0.73
best	-0.58	-0.65	-0.12	-0.35	-0.38
1999	***-0.59***	***-0.79***	***-0.49***	***-0.61***	***-0.68***
	UK correction definition				
worst	-0.66	-0.46	-0.50	-0.62	-0.57
best	-0.62	-0.23	-0.20	-0.35	-0.27
1999	***-0.54***	***-0.45***	***-0.46***	***-0.54***	***-0.58***

More data can be found in Annex 8.

The case of the Netherlands is different. The definitions of budgetary balance used in graph 8 and in table 6 do not take into account the effect known as the "reverse gateway effect", i.e. the fact that export restitutions paid where the port facilities are located, often do not go in favour of nationals of that country. The figures for the Netherlands are influenced by this effect. As long as export restitutions played a

30 A study of the Bundesbank published in November 1993 (Die Finanzbeziehungen der Bundesrepublik Deutschland zu den Europäischen Gemeinschaften seit dem Jahr 1988, Monatsbericht, November 1993) had forecast a negative budgetary position for Germany in 1997 30 per cent higher than the one effectively recorded.

significant role in the Common Agricultural Policy (together with measures for storing surpluses temporarily withdrawn from the markets) the country was a significant recipient of this type of expenditure to the point of appearing for many years as a large net beneficiary. The reforms of the CAP have gradually altered this situation and the Netherlands has gradually become a net contributor to the EU budget as it receives low returns from both the Structural Funds and on direct aids from agricultural expenditure.

However, the position of this country also depends to a large extent on the definition of budgetary balance used and, in particular, on the treatment of customs duties. If balances are calculated according to the provisions of the correction mechanism decided in Fontainebleau, which would neutralise the impact of traditional own resources in the measure[31], the negative balance of the Netherlands is currently somewhat smaller than that of the other countries.

Both Sweden and Austria were expected to have negative balances. The shares in Agricultural and Structural Funds spending that these countries can expect up to 1999 are low. In 1997 these two countries were contributing 3.1 and 2.8 per cent of the EU financing, respectively. Their shares in CAP spending were 1.8 and 2.1 per cent, while their shares in the Structural Funds were 0.9 and 1.4 per cent. A significant amount of spending foreseen for these two countries in 1995 was paid only in 1996 and this explains the apparent improvement of their position in 1996. In 1997, the two countries received Ecu 76 and Ecu 71 millions, respectively, as the penultimate instalment of the temporary compensations decided in the accession treaties.

It has often been underlined that in 1997 Germany's budgetary balance amounted to more than 60 per cent of all negative balances. This estimate, however, was influenced by the strong fluctuations of the UK rebate. In 1999, the budgetary balance of Germany should represent slightly less than 50 per cent of all negative balances. In coming years this percentage is expected to come down further as, following enlargement, more Member States are likely to record negative budgetary balances; it is likely that by 2006 Germany's share in all negative budgetary balances will have decreased to around 40 per cent.

2.3. The impact of Agenda 2000 on the most important budgetary imbalances

To understand the impact of the Agenda 2000 programme on budgetary imbalances it is necessary to consider the effects of both enlargement and the proposed policy reforms.

The countries which will join the Union on the occasion of the next ***enlargement*** have a level of prosperity well below that of all the current members and will therefore become large net beneficiaries. This implies that the budgetary positions of the present 15 Member States will have to undergo a corresponding deterioration

31 See Annex 3 for a discussion of these issues.

which, on the basis of the approach that the Commission outlined in its *Agenda 2000* communication[32], can be estimated at around 0.15 per cent of their GNP by 2006. As the Commission has indicated in *Agenda 2000*, this development *"cannot come as a surprise and should not give rise to claims for compensation"*.

The ***reform of the Common Agricultural Policy*** is not expected to affect significantly the budgetary balances of the five countries examined in this section of the report. However, this must be qualified since the proposals presented by the Commission in March of 1998 contain numerous provisions which may affect payments in the individual Member States. As a result, the eventual precise effects on the budgetary positions of the Member States will depend on the outcome of the current negotiations.

In general terms, the proposed reform aims at reducing the level of guaranteed prices while partially compensating the resulting income losses through increases in direct aids. This may have an effect on the budgetary balances of the Member States which is largely of a purely accounting nature and underscores the fragile nature of the budgetary balances calculations. The most notable example of this is in the case of the Netherlands. At present the Union intervenes in the Netherlands to support the price of produce for which a common market organisation exists through exports restitutions. The expenditure carried out in this country will benefit the producers which may well be situated in other countries; say, in neighbouring Belgium or Germany. As CAP spending moves from market support towards direct aids, the producers in these two countries will be receiving in direct aids some of the support which they were previously deriving from the market intervention measures carried out in the Netherlands. As a result of this change, the recorded budgetary balance of the Netherlands will deteriorate correspondingly while those of Belgium and Germany will improve without any fundamental change in the underlying situation. This consideration must be kept in mind when examining the impact of the CAP reform on the budgetary imbalances of the Member States since it explains some of the expected changes.

In global terms, the reform is expected to lead to an initial increase in CAP spending (until 2003/2004) followed by a stabilisation as implementation of the reform is completed. The overall amount of spending plays also an important role considering that for most countries there is a significant difference between their share in the marginal financing of EU expenditure (i.e. their share in EU GNP) and their share in CAP expenditure which is not expected to change dramatically because of the reform.

The main sectors affected by the reform are arable crops, beef and the dairy products. Considering the parameters of the reform and the importance of these sectors in the agricultural sector of the five countries examined in the previous sections, it is possible to predict that, if the Commission's proposals were to be confirmed by the

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32 Commission of the European Communities (1997): *Agenda 2000 For a Stronger and Wider Union*, COM (97) 2000 and Bulletin of the European Union, Supplement 5/97.

negotiations, the reform of the CAP should not have a significant effect on their budgetary imbalances.

Once the reform of the CAP will have reached its full effect (i.e. towards the end of the period covered by the next Financial Perspective), the budgetary balances of Germany, Sweden and of the United Kingdom, measured as a percentage of their GNP, should hardly change compared to their pre-reform levels. The expected increases in CAP spending received by these countries should be offset by the increases in their contributions to the EU budget provoked by the change in total CAP spending. The budgetary imbalance of the Netherlands could record a small deterioration although this may be largely an accounting effect of the type mentioned at the beginning of the section. The budgetary imbalance of Austria could experience an improvement although this essentially would be the result of the proposed transfer of rural development measures from structural spending ("heading 2" of the Financial Perspective) to agricultural expenditure ("heading 1").

More uncertain are the effects of the reform of ***Structural spending***. The Commission has proposed to maintain the overall EU effort in the structural area constant as a percent of GNP at the level of 0.46 per cent of the GNP of the Union. This effort, however, will have to cover also the structural part of the pre-accession strategy and the aid to the new Member States. For the current 15 Member States the proposed reform implies some decline of total spending measured as a percentage of GNP between 1999 and 2006.

The precise effects of the reform on the individual budgetary imbalances are still uncertain and will depend on the eligibility decisions to be made on the basis of the latest available data and on the outcome of the current negotiations. The general aim of the proposals presented by the Commission is to focus resources on the areas and sectors in greatest need. This is to be achieved through a stricter geographical concentration and through a rationalisation of the modes of intervention. In particular, it is proposed to reduce the number of regions receiving the highest levels of aid through a strict respect of the conditions for eligibility as "objective 1" regions (i. e. GDP per head in purchasing power parities lower than 75 per cent of the EU average). A greater geographical concentration is also sought for the so called "objective 2" regions.

Additional elements which may affect the distribution of Structural Funds spending amongst Member States are the criteria which should be used to determine the level of per head aid in the eligible regions. These criteria include the gap between GDP in the region and the EU average, the relative prosperity of the country and the relative level of unemployment.

However uncertain these elements may be, it is possible to venture some broad considerations which can contribute to a better assessment of the trend of the budgetary imbalances being discussed here. Austria, Germany, the Netherlands, Sweden and the United Kingdom all contribute to the EU budget with shares which are substantially higher than their shares in structural spending and are therefore likely to see some improvement in their budgetary balances due to the lower overall expenditure resulting from the reform, even if this will be concentrated in the regions characterized by the greatest need. This improvement may be greater in the case of Germany. A strict respect of the 75 per cent benchmark for the choice of the "objective 1" regions will not affect this country (except East Berlin). In addition, the overall effect of the criteria for the determination of the aid per head may also be to the advantage of the new Länder.

As a result of the whole Agenda 2000 package, of the five Member States examined in this section, only the Netherlands is expected to experience between 1999 and 2006 a deterioration of its net balance of the same order of magnitude as that mentioned at the beginning of this section as the average impact of enlargement (about 0.15 per cent of GNP). This result, however, is strongly influenced by the mechanical effect of the shift away from CAP market support measures to direct aids payments and should not correspond to a parallel deterioration in the benefits derived by the Dutch economy. The reform of the Structural Funds, on the other hand, should have a small positive effect on the budgetary balance of this country.

The budgetary balances of Austria, Germany and Sweden are expected to deteriorate somewhat less than the impact of enlargement. In the case of Austria, the transfer of rural development measures from the structural funds to the CAP should provoke a less favourable result of the reform of the structural funds matched by a corresponding better outcome of the CAP reform.

Very different is the position of the United Kingdom whose budgetary position (measured as a percentage of its GNP) could remain broadly stable between 1999 and 2006. The reforms of the CAP and of the Structural Funds would not affect negatively the budgetary balance of this country. Furthermore, unless the UK correction is modified, the negative impact of enlargement on the budgetary position of the United Kingdom would be reduced by the operation of the compensation mechanism.

2.4. Options for reform

If a broad agreement on the need to address the issue of budgetary imbalances were to emerge, some key options could be contemplated. These options, which are discussed below, obey a certain logic. First, on the financing side, it is possible to consider that an orthodox and transparent system should be put in place. This would, imply that the UK rebate is progressively eliminated. Secondly, it is possible to consider, in recognition of the fact that the principal cause of budgetary imbalances is the expenditure side of the EU budget, the possibility of implementing reforms on EU spending with the view to reducing these imbalances. And, third, ad hoc solutions on the revenue side of the budget, aimed at redressing the imbalances, can also be contemplated. The present section considers these possibilities sequentially.

2.4.1. Return to a more straightforward system

It could be envisaged progressively to phase out or to reduce the correction presently granted to the United Kingdom . This could find a justification in the fact that after enlargement, the relative prosperity of the United Kingdom, which is already around the EU average today, would almost certainly be above the EU average, thus weakening one of the conditions for the initial granting of the rebate. In addition, with five countries experiencing negative budgetary positions of a similar order of magnitude, the maintenance of a special treatment for just one of them could appear unjustified. The change in the nature of the mechanism mentioned in section 2.1 - from correction of a specific structural agricultural problem to a reduction in the cost of all expenditure decisions - is also a strong argument.

Furthermore, it is conceivable that other changes to the present arrangements might make the maintenance of the rebate superfluous or, at least, less justified. This could, for instance, be the case of the introduction of a correction on the expenditure side along the lines indicated in the next section. But ending the UK rebate by itself would not remove the current imbalances between the contributor Member States.

Table 7

Cost of the UK correction for Germany, the Netherlands, Austria and Sweden

(percentage of GNP, 1995-1997 cash data, 1999 Preliminary Draft Budget)

	Germany	Netherlands	Austria	Sweden
1995	0.02	0.03	0.03	0.03
1996	0.03	0.05	0.05	0.05
1997	0.03	0.05	0.05	0.05
1999	0.04	0.07	0.07	0.07

It is also important to mention that there exist additional possibilities that could contribute towards the development of a more straightforward financing system for the EU. One possibility would be to substitute the GNP resource for the VAT resource. Clearly, as noted earlier, the equity of the system would improve since the regressive elements associated with VAT would be removed. Table 3b (in section 1.2.2) offers an indication, for the year 1997, of the effects, per Member State, of substituting the VAT resource with a theoretical GNP resource. Another possibility would be to substitute all other own resources (including traditional own resources) with the GNP resource (the results for each Member State are also shown in table 3b).

It is clear that there is a trade-off between financial autonomy and simplicity. To replace fiscal resources with direct contribution from Member States may render the system more intelligible and cost effective, but it certainly reduces further financial autonomy and, in the case of TOR, would constitute a significant departure from EU orthodoxy.

2.4.2. *Correction on the expenditure side*

A correction on the expenditure side, which would not require modification of the Own Resources Decision, would be consistent with the Fontainebleau conclusions and would address the fundamental cause of budgetary imbalances. The current imbalances result essentially from Structural Funds and agricultural spending. It would not appear logical to correct the imbalances resulting from structural interventions as these have an explicit redistributive aim. It is however conceivable to modify agricultural spending. Given the integrated nature of the Common Agricultural Policy, it is not possible to modify spending by Member State, but it is possible to reduce the overall amount of spending which is allocated through the EU budget.

Table 8

Implications of a partial reimbursement (75%)[1] of CAP direct aids
(Year 2006, in Euro million and in percent of GNP, at current prices)

	Change in budgetary balance *(before UK correction)*		Change in budgetary balance *(after UK correction)*	
	Euro million	Percent of GNP	Euro million	Percent of GNP
B	110.7	0.03	121.9	0.04
DK	- 100.6	- 0.05	-93.2	-0.04
D	678.2	0.03	733.5	0.03
GR	- 451.7	- 0.30	-446.3	-0.29
E	- 528.2	- 0.07	-503.4	-0.07
F	- 648.5	- 0.04	-585.2	-0.03
IRL	- 195.8	- 0.23	-192.8	-0.22
I	134.5	0.01	186.6	0.01
L	11.6	0.05	12.4	0.05
NL	168.8	0.03	185.7	0.04
Ö	43.8	0.02	53.2	0.02
P	- 23.9	- 0.02	-19.2	-0.01
SF	22.8	0.01	28.1	0.02
S	62.3	0.02	72.6	0.02
UK	429.6	0.03	146.1	0.01
New 6	286.4	0.07	300.0	0.08
Total	0.0		0.0	

1) A rate of reimbursement of 75% of CAP direct aids is equivalent to a reduction of agricultural expenditure spent out of the EU budget of about Euro 9 145 million or 17% of total CAP payments in 2006..

In particular, it is possible to imagine that, while market support expenditure will continue to be integrally reimbursed to Member States, that part of expenditure which goes directly to individual beneficiaries could be reimbursed only partially. The scope for this type of action would increase as the proposed reform of the CAP aims at reducing the weight of market support measures, while the relative weight of direct aids would increase correspondingly (from 65 per cent in 2000 to 75 per cent in 2006). The essential idea is to take advantage of the fact that all the Member States that record large budgetary imbalances have a share in the financing of the EU budget much higher than that in EU agricultural spending, and that a reduction in the overall amount of spending would improve their budgetary balances. Moreover, the original rationale for 100% financing of the CAP market support expenditure (i. e., that market support benefits farmers throughout the Community, not just those in the Member States where the expenditure occurs) is no longer valid for the income aid component.

If implemented, this option would be consistent with and would represent a generalisation of the principles currently governing most EU expenditure and especially that under the Structural Funds. At the same time, it should not be seen as a dismantling of the CAP or a move towards its re-nationalisation. Neither the degree of integration, nor the level of decision making or the overall amount of financial resources available to pursue its objectives would be modified. Farmers would receive the same support as currently since CAP expenditure by Member State is compulsory once determined by the relevant legal provisions. The level and the conditions attached to the payment of these direct aids would continue to be an integral part of the CAP and would result only from EU decisions. The overall amount of spending available would remain the same, but would be shared between the EU budget and the national exchequers.

The fact that a lower share of financial resources would need to be allocated through the EU budget suggests that the agricultural guideline should be reduced if this constraint is to maintain its effectiveness. A corresponding reduction in the Own Resources ceiling might also be appropriate. This could be done on the occasion of the first modification of the Own Resources Decision[33] and, in the meantime, should be replaced by some form of strong engagement not to use the whole ceiling.

Table 8 presents the impact of a 75 per cent partial reimbursement of CAP direct aids. The overall reduction of EU spending in 2006 amounts in this example to Euro 9 145 million. More details on this simulation are presented in Annex 5. The table also shows the negative effects that the introduction of a measure of this type would have on the budgetary balances of some Member States.

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33 On the occasion of the first modification of the Own Resources Decision the reference will have to change from the GNP based on the 2nd edition of the European System of Accounts to the new ESA 95. If the level of the GNP of the EU according to the new system of accounts were to be different, this would justify a corresponding adaptation of the ceiling so as maintain the stability of the financial resources put at the disposal of the EU budget.

2.4.3. *A generalised correction mechanism*

Germany, the Netherlands, Austria and Sweden have asked to benefit from a transformation of the present correction mechanism applying to the UK into a capping model. A simple transposition of the present mechanism is not possible. Applying the present mechanism to all countries that have a negative budgetary balance or simply extending to the four countries that have made the request would result in a three to fourfold increase of cost of the mechanism (see table 9 and the report by the European Court of Auditors (1998)[34]). In addition, depending on the assumptions made, this burden would have to be borne by a group of countries representing less than a fifth of the GNP of the European Union.

The four countries that have made the request, aware of this difficulty, have asked for a modified version of the mechanism. They, correctly, point out that the present mechanism contains various implicit parameters that may be modified. In particular, they point out that whereas the current mechanism corrects 66 per cent of the entirety of the negative balance of the United Kingdom, it is conceivable that Member States be asked to accept a negative balance up to a given percentage of GNP – say 0.3 or 0.4 per cent of GNP – and be granted a compensation only for the part exceeding this threshold. In addition, the benchmark of 66 per cent may also be modified. It is also possible to introduce modifications in the items included in the contributions to the EU budget (e.g. traditional own resources could be excluded or re-apportioned according to different keys) and in those included in expenditure (e.g. to exclude administrative expenditure or expenditure in the new Member States or Structural Funds and so on).

Table 9

Overall redistribution induced by the UK correction mechanism for 1996[1] under different assumptions

(Ecu million)

Mechanism applied to the United Kingdom (present situation)	**Mechanism applied to all the countries with a negative budgetary balance** (UK, D, NL, A, S, F, I)	**Mechanism applied to 5 countries** (UK, D, NL, A, S)
2 856	**12 384**	**11 138**
On the assumption that the beneficiaries are excluded from the financing, the burden would be spread over a number of countries representing the following percentages of EU GNP		
86.5 %	**17.0 %**	**48.9 %**

1) The simulation has been prepared on the basis of 1996 data to make the results comparable to those reported by the European Court of Auditors (1998): op. cit., footnote 38.

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34 European Court of Auditors (1998): *Special report no 6/98 on the system of own resources based on VAT and GNP.* Official Journal of the European Communities C 241, July 31, 1998.

Table 10

Changes in the budgetary balances induced by compensation mechanisms based on different parameters
(Euro million; ***data based on projections for 1999***[1])

Sum of all net rebates	Germany	Netherlands	Austria	Sweden	UK
Present mechanism *(Threshold 0.0 per cent of GNP; rate of reimbursement 66 per cent)*					
4 952	*- 1 008*	*- 311*	*- 173*	*- 189*	+ 4 952
Unconstrained generalised correction mechanism *(Threshold 0.0 per cent of GNP; rate of reimbursement 66 per cent)*					
7 601	+ 4 110	+ 112	+ 68	+ 185	+ 3 126
Difference relative to the present situation					
2 649	+ 5 118	+ 423	+ 241	+ 374	*- 1 826*
Constrained generalised correction mechanism *(Threshold 0.3 per cent of GNP; rate of reimbursement 66 per cent)*					
3 538	+ 1 669	*- 123*	*- 54*	+ 50	+ 1 819
Difference relative to the present situation					
- 1 414	+ 2 677	*+ 188*	*+ 119*	+ 239	*- 3 133*

1) The results are shown for 1999 only because the data for other years are not appropriate. 1996 is not representative for Sweden and Austria; 1997 and 1998 are unrepresentative for the United Kingdom because of the exceptionally high variability of the rebate in these years – see graph 7; the data in the first column under the various extensions of the correction mechanism correspond to the sum of all improvements (financed, equivalently, by the sum of all deteriorations) in budgetary balances reported in column (6) of tables 1 and 3 of Annex 6.

An additional important modification could concern the financing of the rebates. In the present system the United Kingdom does not finance its own rebate. A generalisation could be seen as implying that the Member States benefiting from the system should not finance it. However this solution is not only very costly in a situation where many Member States benefit from the system, but is also fraught with risks. In particular, a "threshold effect" could appear whereby a country with a negative balance just above the threshold would receive a minimal rebate but would be exempted from the burden of financing whereas if it had been just below the threshold it would have had to contribute to the financing of all other rebates for substantial amounts. It seems logical therefore to assume that a Member State should not finance its own rebate, but that it should finance all the others[35] (as assumed in the simulations presented in table 10).

Modifying these parameters provides the system with a substantial degree of flexibility, albeit at the cost of significantly reducing transparency and increasing the complexity of the calculations. However, this flexibility yields mechanisms with different overall costs and different effects for the individual Member States.

Annex 6 discusses some simulations and some key results are reproduced in table 10. The simulations show that any system based on the same parameters for all Member States, and under the assumption that its overall cost is to be maintained within reasonable limits, would lead to substantial reduction in the size of the rebate currently enjoyed by the United Kingdom.

35 See Annex 6 for a discussion of this model and in particular for the opportunity to ignore second round effects, i.e. the case where a country is just below the threshold at the beginning of the exercise, but where it will exceed it once the cost of financing the other rebates is taken into account.

3. Final Comments

The proposals presented by the Commission in *Agenda 2000* indicate that it is possible to face the challenges resulting from enlargement and from the reform of the major EU policies within the own resources ceiling set, for an unlimited time, by the current Own Resources Decision. To achieve this it is essential that the budgetary rigour pursued by the Member States in the framework of EMU characterises also the EU budget.

The shortcomings of the system discussed in the first part of the report do not by themselves provide grounds to justify an urgent modification of the Own Resources Decision. If and when this Decision were to be modified so as to allow an in depth reform of the Own Resources system, these shortcomings could be corrected either through a simplification of the system of contributions or through the introduction of new own resources. The proposed introduction of an element of progressivity could also be discussed in this context.

Currently, the most pressing source of dissatisfaction with the present arrangements appears to be linked to the issue of budgetary imbalances of Germany, the Netherlands, Austria and Sweden. It is not possible, at this stage, to determine with precision how these imbalances will evolve over the next few years as some important policy parameters have yet to be fully articulated. However, it is possible to predict that the imbalances of these large net contributors as a percentage of GNP should deteriorate somewhat, more for the Netherlands than for the others, but most likely less than the average deterioration due to enlargement. This outcome would be due to the proposed containment of spending in the present Member States over the period covered by the next Financial Perspective and to some specific provisions of the proposed reforms.

Establishing correction mechanisms to ameliorate budgetary imbalances is a difficult task since, for a given size of the EU budget, an improvement in the budgetary position of some Member States invariably involves a corresponding deterioration in the budgetary position of others. If a consensus were to emerge on the need to address the issue of budgetary imbalances, a decision would have to be taken on how to achieve this result and on the timing of the changes.

The report indicates three, mutually compatible, options:

- ***on the financing side***: a simplification of the financing structure in favour of a system more, or even totally, based on GNP contributions; such a simplification could also include the phasing out of the existing correction mechanism;
- ***on the expenditure side***: the introduction of a system of partial reimbursement of CAP spending aimed at directly supporting incomes;
- ***on the balances***: the application of a generalized correction mechanism to all Member States experiencing large imbalances.

None of the options discussed in the report provides an ideal solution. Technical and conceptual weaknesses can be found in all of them. The shifts in the burden of financing that results from some of these options present regressive elements that might need a redress in the context of an overall solution.

The timing of any changes would depend on whether it will be necessary to modify the Own Resources Decision or not. A modification would entail long ratification delays and would suggest a process allowing the new financing system to become effective at the time of the accession of the first group of new Member States. Enlargement would indeed represent such a significant change of circumstances as to warrant a structural modification of this type.

The significant methodological and conceptual reserves that the Commission has on the issue of budgetary imbalances have prompted it to limit this report to a review of options for their correction. If a broad agreement towards a solution of the problem were to appear within the European Council, the Commission would put forward the appropriate detailed proposals.

The evolution of the EU financing system[1]

During the period 1958-1970 the Community budget was financed exclusively by contributions from the Member States. The *Luxembourg European Council* of 21-22 April 1970 introduced for the first time a system of own resources for the general budget of the Community taking effect in 1971. One objective was to gradually enhance the Community's financial independence from Member States' transfers. The own resources introduced were customs duties and agricultural levies (which were to become known as the Traditional Own Resources, TOR) and one based on a harmonised VAT base. While traditional own resources became effectively own resources over the period 1971-1975, difficulties with establishing a common VAT system across the Member States and with defining the base for VAT assessment delayed the introduction of VAT as an own resource until 1979.

In the period 1975-1987 revenue growth on the own resources account was eroded by a diminishing yield from TORs while revenues from VAT were adversely affected by the generally weak economic growth prevailing during this period. At the same time, the strengthening of existing and the launching of new policies, the inability to contain spending on the Common Agricultural Policy (CAP) and expenditure growth associated with the two enlargements[2] led to pronounced resource inadequacy. Persistent complaints on the part of the UK concerning its financial contribution also became a feature of the budgetary disputes that were prominent during this period.

A temporary resolution of the budget difficulties was secured at the *Fontainebleau European Council*. The Fontainebleau Council of June 25-26, 1984 increased the maximum rate of call for the VAT resource to 1.4 per cent and established a correction mechanism for budgetary imbalances which has since applied only to the UK[3].

The modifications to the financing system introduced by the Fontainebleau Council proved almost immediately insufficient. They failed to generate sufficient revenues owing to the continuing decline in revenues from TORs and to the slow growth in revenues from the VAT resource. In addition, some dissatisfaction started to appear with the VAT based resource which, being based on consumption, was felt to contain a significant regressive element. The problem of revenue inadequacy and inequity was compounded by rising, and incompletely anticipated, expenditure commitments. These

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1 For a detailed review of the history as well as an assessment of the EU financial arrangements up to the early years of the Edinburgh agreement see Commission of the European Communities (1995): *European Union Public Finance*, Luxembourg; see also the discussion in Commission of the European Communities (1997): "Budget Contributions, EU Expenditure, Budgetary Balances and Relative Prosperity of the Member States", paper prepared by DG-XIX and forwarded to the Ecofin Ministers by President Santer for their October 13 meeting.

2 Greece joined the Community in 1981 followed by Spain and Portugal in 1986.

3 See Fontainebleau European Council, Conclusions of the Presidency, Bulletin of the European Communities 6-1984.

were related to difficulties in controlling spending on the Common Agricultural Policy (CAP), especially following the accession of Portugal and Spain, the dollar depreciation after the spring 1985 and the fall in international commodity prices, factors which added considerably to the financing of export restitutions.

Fundamental reforms, which determined the character of the present own resources system, were adopted in June 1988[4]. Among the principal reforms of the Brussels European Council was the introduction of a new own resource based on the Member States' GNP (intended to match contributions closer to the ability to pay), and that of an overall ceiling to the total amount of own resources which could be called to finance Community spending. This payments ceiling was set at 1.15 per cent in 1988 with progressive yearly increases which were to bring it to 1.20 per cent by 1992. The Council also limited the role of the VAT resource by introducing a capping of its base at 55 per cent of GNP, a measure intended to reduce the effects of the regressive character of the resource.

The consolidation of the 1988 reforms and ultimately of the Community finances took place within a context where the Community's ambitions, expressed in the Treaty on European Union, grew significantly. The *Edinburgh agreement* of December 1992, which adopted the financial perspective for the years 1993-1999, increased the overall ceiling of own resources from 1.20 to 1.27 per cent. In addition, it introduced steps to decrease further the importance of VAT in the financing of the budget.

However, the system of own resources decided in Edinburgh could only enter into force on January 1, 1995. In the meantime, significant difficulties were experienced during the recession years of the early 1990s when initial budget estimates turned out to be too optimistic. Successive downward revisions in economic growth during 1992-1994 resulted in corresponding revisions to budget revenues. Nevertheless, despite the adverse climate, it was possible to respect the constraints imposed by the own resources ceiling without undermining financial discipline.

In subsequent years budgetary arrangements have proved generally successful. In addition, from 1997 cautious annual budgetary decisions have lead to spending levels significantly lower to those foreseen in the Financial Perspective. As a result, the European Union approaches the challenges resulting from enlargement to Cyprus and to the countries of central and eastern Europe and from the reform of its main policies with substantial margins under the own resources ceiling.

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4 See Council Decision 88/376/EEC, Euratom of June 24, 1988, On the System of the Communities' Own Resources, *Official Journal of the European Communities*, L 185, July 15, 1988.

A review of possible own resources for the European Union

1. INTRODUCTION

The issue of the financial autonomy of the EU is central to the debate about new own resources. The Luxembourg agreement of 21-22 April 1970 provided that the replacement of Member States contributions by own resources was meant to finance the complete budget. However, this financial autonomy has proved elusive. A dominant part of the EU budget is currently financed by block grants in the form of VAT and GNP contributions from the treasuries of the Member States. To remedy this situation, proposals for different categories of new own resources have on occasion been made[1]. The purpose of this annex is to provide a critical review of some of the most important of these proposals.

There are three sections in the Annex following the introduction. Section 2 presents the criteria against which the suitability of proposed own resources can be evaluated; section 3 examines eight specific proposals in detail; and section 4 concludes.

2. CRITERIA FOR OWN RESOURCES

The theory of fiscal federalism predicts that the assignment of tax competencies at different levels of authority rests on two important economic considerations and also on several subsidiary criteria. The former, which are the primary criteria, are:

- the presence of externalities which transcend national borders; and
- the regional arbitrariness of the tax base/of the tax revenue[2].

- If the tax in question has ***external*** effects which go beyond the locality where it is levied, then it ought to be optimally assigned to the higher level of authority. Two broad cases can be considered here. First, taxation that affects the prices of

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1 For the general principle in favor of own resources, see for example, European Parliament (1990). The report "Insists that the Community budget must be financed from the Community's own resources"; Part A, para. 10. Some of these issues have also been considered in Commission of the European Communities (1992). The quest for new own resources dates back to the 1970s; see, for example, the MacDougall (1977) report, vol. II, ch. 16, p. 479-504.

2 For a discussion of these criteria as they apply to the case of the European Union see Commission of the European Communities (1993a), ch. 7, Begg et. al. (1997) and Keen (1995), section 2, p. 9-39. See also Bureau and Champsaur (1992), Commission of the European Communities (1992c), section IV.3, European Parliament (1994), p. 3, and Commission of the European Communities (1993a), Table 30, p. 84 for a (somewhat dated) summary of the assignment of tax competencies in selected federal states in 1988.

internationally traded goods or factors of production in imperfectly competitive markets; this can lead to distortion of competition between national fiscal systems, an important factor at the background of the process of indirect tax harmonisation undertaken in the EU. And, second, taxation levied on mobile tax bases. A parallel version of the criterion states that if the benefit from a particular service transcends national borders, then the financing of the service ought to be assigned to a higher level of government. Clearly, in the presence of externalities subsidiarity, despite its importance, becomes a secondary issue since economic efficiency predicts that the tax should be assigned not to a national but to a supranational level[3].

- ***Regional arbitrariness*** refers to the impossibility to reasonably define the base of the tax or, alternatively, to the arbitrary distribution of the revenue in the case where the tax is levied locally. Revenues from the common external tariff constitute a clear example of the latter. Here, especially as a consequence of the internal market, it is difficult to determine with accuracy the national base that ultimately bears the tariff. Should the tariff be levied in, say, the port of Genoa, the revenues from the tariff only partly belong to the citizens of Italy since such imports, once in the EU, are consumed widely by all European consumers. Revenues from customs and agricultural levies are currently assigned to the EU level (with the Member States simply collecting the levies) because they comply with the criterion of regional arbitrariness[4].

Several secondary criteria for assigning tax instruments to a supranational level of government ought also to be considered. First, in order to ensure ***horizontal equity***[5] in

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3 Leaving aside externalities or revenue arbitrariness, subsidiarity is a crucial issue here; see, for example, the importance accorded to it in the motion for a resolution in European Parliament (1994). It is possible to argue that full respect of the subsidiarity principle would be consistent with Member States contributing to the EU budget a specified amount, however defined, but themselves alone having the responsibility to decide on the sources of financing and the tax instruments to be used, in order to respect their EU financing obligation. However, Bureau and Champsaur (1992), p. 89, caution that "budgetary intervention at the Community level ought to be admitted only in the presence of cross-border externalities or economies of scale, which cannot be properly alleviated by a simple coordination between concerned national governments".

4 Despite the presumption, there is very little concrete evidence on the quantitative importance of regional arbitrariness in the case of traditional own resources. Nevertheless, according to recent estimates 27 per cent of the total amount of customs duties levied in the Netherlands, and 31 per cent of the import duties levied in Antwerp, are related to final consumption of goods in other Member States. Taking account of this alters considerably the unadjusted shares of Belgium and of the Netherlands in traditional own resources. For example, instead of amounting to 7.4 per cent and 12.2 per cent of total traditional own resources contributions in 1997, respectively, adjusting the data for the presence of the gateway effect would reduce the share of Belgium to 5.1 per cent and of the Netherlands to 8.9 per cent For the details of the estimates see Verbeke et. al. (1998a) and Verbeke et. al. (1998b).

5 Horizontal equity refers to the concept of individuals (or nations) in identical circumstances are treated identically in their tax liability; vertical equity, on the other hand, refers to the notion where individuals (or nations) in different circumstances are accordingly differentiated in their tax liability. Clearly, it is not straightforward to extend the application of these principles from individual

contributions across Member States, a definition of equal treatment for tax purposes is important (the need for vertical equity, or solidarity to use a term commonly employed in the context of the EU, is addressed through the EU's expenditure policies). Here, the proportionality of the relationship between gross contributions and GNP is the basis on which horizontal equity can evaluated[6].

The second criterion, ***visibility to EU citizens***, has an important accountability dimension. Given the complex nature of EU finances, comprehension and monitoring of the present system on the part of citizens is virtually absent. For example, from the point of view of EU citizens, the GNP contributions are clearly invisible, but also the relationship between VAT taxes paid and collected by the Member States and their contributions on the VAT resource is not easily comprehensible[7]. Moreover, while Member States themselves perform this monitoring function, the lack of a direct relationship between citizen and budget is another manifestation of the "democratic deficit"[8]. Changes through the introduction of new own resources ought to improve transparency by conveying information about EU financial relationships[9].

A third criterion concerns ***links to common policies*** and requires that new own resources ought to be those which are consistent with the other EU policy objectives. Financing the EU budget through taxes that, at the same time, advance common objectives on, say, transport policy or environmental standards would be consistent with this criterion.

To avoid distortions and to enhance acceptability the tax ought to be levied on a ***harmonised base***. Few existing taxes enjoy at present a sufficient degree of harmonisation in their base. VAT and excise taxes come closest to the necessary standard.

A further set of criteria concerning ***sufficiency, efficiency and cost-effectiveness*** refer to administrative aspects of new own resources. The revenue from new own resources ought to be sufficient to finance a dominant part, if not all the resource needs, of the

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taxpayers within a nation to regions within a federation or to the Member States in their relationship with the EU budget.

6 This was discussed already in Commission of the European Communities (1997a). Note, however, that suggestions have on occasion been made for a more progressive resource as, for example, in Padoa-Schioppa (1987), p. 136; in recent years, Spain has also insisted on the establishment of a progressive resource.

7 See European Communities Court of Auditors (1998) for a criticism related to this point.

8 The "democratic deficit" is usually meant to suggest lack of full parliamentary scrutiny by and accountability to the European Parliament; presently, the term is used to indicate a manifestation of this in the form of the incomplete monitoring and control of the budget by the citizen.

9 The European Parliament (1990) report emphasizes that "the development of a genuine system of own resources to replace the contributions from the Member States could take the form of a direct link between the Community and the taxpayer"; see European Parliament (1990), Part A, para. 15.

budget; it should also be stable and predictable and subject neither to unforeseen fluctuations nor to a trend decline.

The manner in which this revenue is collected ought to be efficient in the sense of being assigned to the level of government where tax losses and fraud are minimised. The tax ought to be consistent with improving economic efficiency as well, in that it ought not to discriminate against activities promoted by national or EU policies.

Cost-effectiveness as a criterion refers to tax administration arrangements that maximise the revenue/cost ratio. Assigning an EU tax to a higher level of government could contribute to reducing duplication of tax administration services, and it could also make possible the exploitation of economies of scale in tax collection. At the same time, however, legal, institutional and language differences among the Member States do not necessarily favour assigning the EU tax to a higher level of government; on the contrary, it may be less costly to permit a lower level of tax authority to implement collection, an arrangement which could be particularly effective if combined with incentives to Member States to act efficiently. A clear example is the collection of revenues from traditional own resources by Member States on behalf of the EU.

3. PROPOSALS FOR NEW OWN RESOURCES

The present section examines eight resources that have been proposed on various occasions as new own resources. These are, a CO_2/Energy tax; a modulated VAT tax; excise taxes on tobacco, alcohol and mineral oil; corporate income tax; communications taxes; personal income tax; withholding tax on interest income; and ECB seigniorage. The review takes the form of commentary and, for a convenient summary, of a tabular presentation of the principal issues at the end of the discussion of each resource.

3.1. $C0_2$/Energy tax

This tax was proposed by the Commission in October 1991, reflecting the increasing awareness of potential environmental degradation due to high carbon dioxide emissions. The Commission set the objective of stabilising CO_2 emissions by 2000 at their 1990 level. The proposal, which foresaw an increase in the tax to USD 10 per barrel of oil by the end of the century, was virtually abandoned following considerable opposition in the Council. In order to overcome this opposition, a revised proposal was put forward in May 1995 which introduced the concept of a transitional stage whereby Member States would agree the scope and structure of a common tax but would be free to decide product by product, whether to introduce a positive rate of tax and the level of tax they wished to apply. However, discussions on this revised proposal broke down on the question of what was to happen at the end of the transitional period. Following this, the Ecofin Council of March 11, 1996 called on the Commission to prepare new proposals for the taxation of energy products by expanding the Community excise duty rules on mineral oils into a new taxation scheme for all energy products. The European

Parliament and the Economic and Social Committee have also argued in favour of such an approach.

The Commission has prepared new proposals intended to strengthen the deepening of the internal market and at the same time to permit the introduction of energy taxation according to national preferences including the granting of tax exemptions for energy-intensive industries. Furthermore, environmental protection, the development of a sustainable transport policy and the support of EU competitiveness are also objectives of the proposals[10]. The aim of the proposals is to establish minimum levels of taxation for an enlarged group of energy products. It is clear, however, that the proposals have not been prepared with the view to facilitating the establishment of new own resources.

- The CO_2/energy tax meets the externality criterion since pollution transcends national frontiers. The tax as such could be seen as a means to internalise the negative externalities associated with pollution. However, given the disparate level of development and of energy use across the Member States, such a tax would undoubtedly not perform well on grounds of equity[11]. Furthermore, since it is possible, as envisaged in the initial Commission proposal, to exempt certain firms/sectors from the tax on grounds of undertaking energy-saving innovations this would also effect equity adversely. Failing the equity criterion, however, is secondary since the primary objective of such taxation is, inevitably, to penalise polluters.

- Base harmonisation is non-existent although under the Commission's proposals for minimum taxation of energy products considerable harmonisation could be achieved in the future.

- On the criterion of visibility, while it is possible to design the taxation in question in a transparent manner for the benefit of EU citizens, the possibility of taxing both intermediate and final products will likely attenuate the visibility link between the revenues and the financing of the EU budget.

- Regarding links to common policies, a CO_2/Energy tax scores high since it is consistent with the EU's environmental objectives. Moreover, it is consistent with the Commission's proposals for establishing minimum levels of taxation for energy products across the Single Market. The Commission has also suggested using

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10 See Commission of the European Communities (1997b) and Commission of the European Communities (1997c).

11 Estimates by the Commission suggest that with a USD 10 per barrel the tax would amount to as little as 0.79 per cent of GDP in France and as much as 3.08 per cent of GDP in Luxembourg; Greece would contribute the equivalent of 2.45 per cent of GDP, Ireland 1.93 per cent of GDP and the UK 1.53 per cent of GDP; see Commission of the European Communities (1993a), Table 33.

environmental taxes as a means to reduce the burden of taxation on labour and foster employment growth without endangering budget restraint[12].

- It is uncertain whether the tax would yield sufficient and predictable revenues. According to Commission estimates, a USD 10 per barrel would yield the equivalent of about one percent of EU GNP, clearly sufficient to finance a large part of current and projected EU expenditure. However, revenue from this tax will undoubtedly be unpredictable since it will be levied on cyclically prone sectors exhibiting large variability with respect to economic fluctuations. Moreover, it is possible that energy substitution will take place on a scale sufficiently large to undermine revenues from this source and its suitability as an own resource for the EU.

- On grounds of efficiency and cost-effectiveness it is difficult to evaluate the CO_2 tax. It is possible to levy the tax at the stage of primary production, at the import stage and at the stage of final consumption/use. The optimal stage, from the perspective of the criterion, is that of primary production and imports; however, in this case it would not be possible to exclude preferred sectors. Until explicit proposals have been defined at a practical level, it is difficult to determine the administrative costs/advantages, although it is likely that under some circumstances the tax would be administered effectively.

- Several Member States have objected to this tax for reasons of protecting their international competitiveness. An additional consideration may have been the desire to keep their carbon taxes low in order to protect some energy-intensive domestic producers. A co-ordinated implementation of carbon taxes with EU wide tax exemptions would be necessary to internalise these externalities and also to reduce environmental damage.

As they are predominantly allocative taxes, energy taxes should be expected to and, indeed, fare poorly in terms of equity and tend to be regressive across Member States. This is a lesser concern given the primary objective of the tax. At the same time, however, if it were possible to reach a Council agreement on the complex and fundamental issues involved, which until now has proved impossible, this tax would probably be one of the most serious candidates for a genuine EU resource.

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12 See Commission of the European Communities (1994a), p. 156, for a discussion, and also Drèze and Malinvaud (1994b). If revenue for the EU is indeed raised through a CO_2/energy tax, GNP contributions would decrease correspondingly and Member States could pass this on to their economies through lower taxes on labour.

Box 1 — CO_2/Energy tax	
Criteria	*Performance*
Equity	*Equity would not be served well since the tax would be paid proportionately more by those Member States dependent on older and more pollution-intensive technology; however, this is an inevitable consequence of such taxation. Should it be possible to exempt certain firms/sectors for the tax, adverse distributional consequences would also follow. Negative pollution-related externalities could be internalised through a tax assigned to the EU.*
Base harmonisation	*Currently non-existent.*
Visibility to taxpayers	*The link between the tax and EU policies could be made visible. However, with the tax applying to both final and intermediate products visibility may not be as transparent as desired.*
Link to common policies	*Clearly linked to Community environmental and tax harmonisation policies.*
Revenue sufficiency, efficiency and cost-effectiveness	*A tax of USD10 per barrel could raise revenues equivalent to about 1% of EU GNP. However, it is possible that substitution away from pollution-intensive activities could ultimately lead to diminishing revenues. Moreover, revenues may be too sensitive to business cycle movements undermining sufficiency at a time of an economic downturn. The tax could be administered efficiently and effectively.*

3.2. Modulated VAT tax

The present VAT-based resource constitutes a significant source of financing in the EU budget. Although reforms implemented following the 1988 and the 1994 Own Resources Decisions have improved on undesirable characteristics of this tax significant difficulties remain to be addressed. Nevertheless, support for a tax based on VAT as a new own resource continues to remain buoyant. In recent years, the principal advocate for establishing a new own resource on VAT has been the European Parliament which has developed extensively the case in a 1994 report[13].

The report favours the replacement of the third and fourth resource by a *new* third resource based on VAT, and taking the form of a specific percentage of VAT imposed for the benefit of the EU and levied together with the national VAT taxation. There would, therefore, be a combined VAT rate consisting of the national and the EU rate. The report also argues in favour of a common rate across the Member States differentiated across commodities. To contribute to equity across individuals within the Member States, the report proposes that there would be two VAT rates, a lower one and

13 See European Parliament (1994). It should be stressed, however, that there are reservations in the European Parliament itself regarding VAT as an own resource. The European Parliament (1990) report notes "that VAT, which has become the main source of revenue, while having the advantage of being applied to a tax which is almost harmonized, has the grave disadvantage of inter-personal and spatial regressivity, and should therefore not occupy in future the pre-eminent position it enjoys at the moment"; see European Parliament (1990), Part A, para. 16.

a higher one, for example, the former at 1.5 per cent and the latter at 3.0 per cent. The report argues that the tax would be imposed on a harmonised VAT base through declarations stating clearly on each invoice that it is an EU tax. Thus, both national parliaments and the EU would be granted the power to determine separately which rate would be imposed for purposes of the national budget and which for the EU budget, respectively. The amounts collected would therefore have a direct link to the EU budget in the eyes of citizens/taxpayers.

Given the possibility of inequities in gross contributions resulting from such a system, the report favours an equalisation mechanism[14] based on GNP. The proposed mechanism would be based on establishment of all EU budget resources in a given year in terms of a fixed share in EU GNP. If a Member State's total contributions at the end of the year as percent of its GNP was lower (higher) than the predetermined benchmark then the Member State would make additional payments (receive refunds) equal to the difference between the two shares. In this manner, the proposed system could accommodate country-specific characteristics (regional development etc) and fine tune the own resources system in order to ensure improved equity in gross contributions.

- Taxation in the form of VAT is generally regressive with relatively less well off Member States contributing proportionately more as a result of the lower share of savings in national income (the criterion of vertical equity is not satisfied). Recognition of this aspect has led to the capping of the VAT base as well as to the reduction of the VAT call rate and, as a result, the share of VAT in total budget resources has diminished.

- It is difficult to see VAT payments as deriving from a common EU source. VAT revenues are nation-specific and, therefore, the criterion of regional arbitrariness is likely not satisfied.

- The implementation of this tax as proposed in the European Parliament (1994) report could conflict with national tax setting and especially national budgetary priorities unless close co-ordination of tax decisions at the two levels of government is put in place. In particular, there may be difficulties in integrating an EU VAT tax within the national VAT taxation, especially in light of proposals for a minimum VAT taxation in the EU. However, Keen (1995) suggests that although it is possible that the combined (national and EU) VAT rate may be set too high, this remains an empirical question that cannot be resolved a priori.

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14 An equalization mechanism had already been proposed, also by the European Parliament, in the early 1980s; see European Parliament (1984), article 73.

- VAT base harmonisation is advanced. Following the Sixth VAT Directive[15], and barring the possibility of changing the basket of goods and services subject to minimum VAT taxation, base harmonisation is now substantial.

- In the form of two separate tax rates, a national and an EU one, the tax will undoubtedly be highly visible to taxpayers/citizens and is certain to be understood as a contribution to the EU budget, thus improving on the democratic deficit.

- It is likely that the tax will yield sufficient revenues for the purposes of the EU budget. Nevertheless, private consumption, which would be the principal component of the VAT tax base, has pronounced cyclical characteristics. Fluctuations in private consumption are a leading cause of business cycles. The replacement of the current 3rd and 4th resources with a VAT resource of the type proposed would undoubtedly raise the variability of EU budget revenues. It is worth recalling that the recession of the early 1990s had significant effects on EU revenues during that period.

- The co-occupancy of the same base by national and EU authorities will contribute to reducing compliance and monitoring costs (compared to introducing an independent a new tax) and to also limiting the extent of tax fraud, evasion and avoidance. With the national VAT rate exceeding significantly the EU one Member States should have sufficiently strong incentives to monitor compliance on the part of taxpayers. Nevertheless, the present experience with VAT revenue performance since the recession indicates that problems of compliance may be important.

In order to ensure that fiscal obstacles to the completion of the Single Market are abolished the Sixth VAT Directive provided that a definitive VAT system ought to be based on taxation in the Member State where the goods or services are supplied[16]. The Commission has put forward ideas for minimum VAT taxation which are consistent with the origin-based system[17] and which are likely to ease some of the drawbacks currently characterising VAT as an own resource.

With an origin-based VAT system for the EU, VAT might present itself as a good candidate for a genuine own resource. It has considerable attractions in terms of visibility, adequacy and buoyancy although some key reservations cannot be ignored. However, a principal difficulty relates to the regressive nature of the tax. Should it be necessary to introduce corrections in the form of a GNP-related equalisation

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15 See Council Directive 91/680/EEC.

16 See Council Directive 91/680/EEC.

17 See Commission of the European Communities (1996), and Commission of the European Communities (1997d).

mechanism, some of the attractions of this resource (for example, the link with the tax actually paid by taxpayers and its transparency) would disappear.

Box 2

Modulated VAT tax

Criteria	Performance
Equity	Despite modifications VAT continues to be a regressive tax for the EU. No cross-border externalities although moving to an origin-based VAT goes in the directions of making VAT an EU tax. Not entirely consistent with national tax objectives.
Base harmonisation	Substantial, following the Sixth VAT Directive.
Visibility to taxpayers	Highly visible, especially if recorded on each transaction along with the national VAT, and familiar to taxpayers.
Link to common policies	Consistent with the establishment of EU-wide minimum tax rules.
Revenue sufficiency, efficiency and cost-effectiveness	Likely sufficient resources will become available, although they could exhibit high variability; it is possible to administer the system effectively although administrative costs will certainly be higher than under the present system.

3.3. Excise duties on tobacco, alcohol and mineral oil

Excise duties are taxes levied on the production or consumption of specific goods. In the EU excise duties apply to a narrow group of goods, tobacco, alcohol and mineral oils. One attraction of excise taxes is the perceived ease of introduction and the sufficiency of revenues. Currently all Member States impose such taxes but there are enormous differences between the rates applied. Although tobacco and alcohol excises in particular are regarded as important instruments of national social policy it is conceivable that part of their yield could be assigned to the EU level.

Currently, excises rates are subject to minimum rules in the EU but the levels are very low and, as a result, they permit wide differences among Member States that have chosen to levy excises at often significantly higher rates. Excises are often employed for reasons of public health and, as a result, they reflect to a considerable extent national socio-political priorities. The European Parliament (1994) report, by referring to them as "educational taxes", considered such excises in a similar light too. The report also acknowledged that on equity grounds they would be inappropriate as new resources for the budget.

The share of the bases of the excises in GNP differs substantially across the Member States. Consequently, if it were that Member States contribute on the basis of a common rate levied on the actual bases of excise duties, the proportions in contributions by Member State would differ widely. This would not be consistent with equity across the Member States while, at the same time, such taxes are also regressive across consumers (smoking is a clear case). Nevertheless, such regressivity is a part of the design and policy objectives of excise duties and should not necessarily be considered as a drawback in the present context.

Beyond revenue considerations, taxing demerit goods is increasingly seen as promoting allocative objectives. Consumption of such goods can be a serious hazard to health and imposes considerable costs in containment and treatment of diseases. Moreover, excises on mineral oils can be regarded as serving environmental objectives. The tax base, especially for tobacco and alcohol excises, is narrow. Revenues from demerit goods are characterised by low elasticities with respect to GNP but they display high elasticities with respect to changes in the excise tax rates since the goods on which they are levied tend to be price-inelastic[18]. Despite their "educational nature" it is of course questionable whether it is appropriate to base the financing of the EU budget on dissuasive taxation, especially since in the long-run consumption of these goods could perhaps follow a diminishing trend.

The EU's involvement in the area of excise taxation is based on the requirement to ensure unrestricted mobility of goods subject to these duties within the internal market. Presently, several directives govern excise rates and structures in the EU[19]. They define minimum excise rates for each product type and determine the product types subject to excise levies and explain the method of implementing the duties as well as the criteria for exemptions or preferential treatment as the case may be. As a result of these steps, considerable if yet still incomplete base harmonisation has been achieved. In the case of mineral oils in particular, exemptions continue to be numerous[20]. The Commission has proposed, in the context of the Single Market, extending the scope of taxation to cover all energy products, especially taking into account the wish of several Member States to pursue environmental objectives under the umbrella of EU initiatives[21]. The Commission considers the removal of indirect tax obstacles to the completion of the Single Market as a policy priority[22].

- Excise taxes, particularly those on demerit goods, are regressive both across Member States and across individuals. Equity concerns would, therefore, arise but this is not a decisive drawback being an inevitable consequence of such taxation. Moreover, the differences in shares across the Member States reflect differences in the rates of national tax systems. Taxation of mineral oil also creates equity problems as mentioned previously under heading 3.3.

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18 See Begg et. al. (1997), p.40.

19 The earliest dates back to original Single Market program and the latest concerns the harmonization of excises on mineral oil, Commission of the European Communities (1997b). There are in total seven Directives on excise rates and structures currently in force.

20 While EU legislation governing excises on mineral oils requires a single rate per product, Member States can request to maintain or introduce reduced rates or exemptions on grounds of specific policy considerations under Article 8(4), Directive 92/81/EEC.

21 See Commission of the European Communities (1995).

22 See Commission of the European Communities (1997d), p. 5-7, 16 and 26 for a discussion.

- The assignment of part of the excise taxation to the EU level would be favoured in the circumstances where it is necessary to internalise trans-border pollution externalities.

- On the other hand, however, national preferences for particular policies regarding demerit goods may not be adequately accounted for under an EU assignment, thus violating the subsidiarity principle. Respecting local preferences argues clearly in favour of assigning these taxes to national parliaments.

- There is only moderate visibility to taxpayers/citizens.

- The main area where there are links with common policies is in the field of mineral oils where there is some degree of interrelation with transport, environmental and energy policies. In addition, there are some, albeit tenuous, links with health/consumer protection objectives.

- Low price and income elasticities suggest that the revenue from these taxes is stable; also, consumption of demerit goods is not cyclical. Excise rates tend to be changed relatively frequently to adjust for inflation or to obtain increased government revenue but the revenue consequences of these changes are not predictable with a great degree of accuracy.

- Harmonisation at the EU level has not advanced as much as in the case of VAT particularly in respect of rate levels.

- Administration and collection costs will be substantially higher than it is the case for the current own resources. Nevertheless, relying on present administration structures could alleviate these costs. Co-habitation by national and EU authorities on the same tax base could also give rise to conflicts similar to those encountered in the case of VAT discussed previously.

Box 3

Excise duties on tobacco, alcohol and mineral oil

Criteria	*Performance*
Equity	*The equity of the yield of these taxes may be poor, but given the characteristics of the goods being taxed this may be a secondary consideration.*
Base harmonisation	*Advanced.*
Visibility to taxpayers	*Moderate/Low.*
Link to common policies	*Tax harmonisation linked to internal market policies.*
Revenue sufficiency, efficiency and cost-effectiveness	*Although the base is narrow, revenue could be substantial. Low income and price elasticities of tobacco and alcohol imply stable revenues. A Community tax is unlikely to cause additional compliance costs. Evasion and fraud in the area of excises is significant, reflecting the generally high level of rates levied.*

Excises suffer notably from equity concerns. Despite finding favour for discouraging consumption of demerit goods, and for promoting environmental objectives, Member States may not be willing to share important fiscal instruments.

3.4. Corporate income tax

Using corporate income as a tax base for a new own resource has been examined on several occasions[23]. At the background of these proposals is the evidence that revenues from corporate taxes are an important component of national budget revenues[24] and also that in federations corporate tax revenues are either shared between different levels of government or the different levels of government impose their own corporate taxes. Moreover, the benefit taxation principle predicts that those benefiting from current policies ought to pay for the policies. In the present case, corporations are expected to benefit substantially both from the Single Market and from EMU, the former through the expansion of the domestic market and the latter as a result of price transparency and enhanced competition. In this perspective, corporate taxation holds the promise not only to provide sufficient resources for the EU budget as well but also to be consistent with the practice in national tax systems.

Keen (1995) points to three dimensions of interest of the corporate tax system in Europe. First, the schedule of statutory rates at which the tax is levied; according to Albi et. al. (1997), in 1996 these ranged from 28 per cent in Finland and Sweden and 33 per cent in the UK to 55.9 per cent in Germany and 53.2 per cent in Italy[25]. Second, the definition of the tax base upon which the tax is levied. Here, the variety of regulations and exemptions governing corporate income, including provisions for international taxation, constitute a complex and intractable problem. And, third, the extent to which the corporate tax is integrated with the personal income tax code so that corporate taxes are measured against personal tax liabilities[26]. He concludes that there is substantial variation across the Member States in terms of the three aspects although, as pointed out by the Ruding Report, there has been a considerable amount of convergence in recent years[27]. The severest difficulty for corporate taxation to become an own resource is the

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23 See, for example, the report by the European Parliament (1990); for a recent thorough review of the issues involved see Albi et. al. (1997).

24 According to Eurostat, in 1995 these amounted to as little as 1.6 per cent of GDP in Germany and as much as 5.1 per cent of GDP in Luxembourg; for the EU-15, they were 2.4 per cent of GDP. They also ranged from a low of 2.9 per cent of total tax revenues in Austria to a high of 11.6 per cent in Luxembourg, while for EU-15 they amounted to 5.7 per cent of total tax revenues.

25 See Albi et. al. (1997), chart 1, p. 39.

26 See Keen (1995), section 3.8, p. 64 and also Commission of the European Communities (1993a), ch. 7, p. 87-88.

27 See Commission of the European Communities (1992d), especially ch. 8, p. 153-185. Bureau and Champsaur (1992) attribute this convergence to the improved tax treatment accorded to capital

diversity of the tax base in the EU. Unlike similar obstacles encountered in the case of other potential candidates, the degree of base diversity in corporate taxation constitutes a serious disadvantage[28].

Albi et. al. (1997) examined the possibility of responding to the base diversity in the context of considering corporate taxation as an own resource. In reviewing potential indicators for measuring the corporate sector's contributive capacity to the EU, they concluded that the profit or loss account could be a reasonable base. However, it was found to be second best compared to the definition of the corporate base in terms of the "real" corporate flow of funds[29]. The latter, which is the equivalent of an expenditure tax in the area of corporate taxation, was found to be appealing from both the economic and the administrative perspective. Spahn (1993) is also favouring this concept[30]. However, even in this case significant difficulties would have first to be resolved before serious consideration is given to this candidate.

- Assigning corporate taxation to the level of the EU reflects several concerns[31]. Because of the lack of exact specificity of the incidence of corporate taxes, some degree of centralisation at a higher level of authority can be optimal; corporate taxes are invariably paid by consumers and producers whose residence does not necessarily coincide with the jurisdiction of the tax-imposing authority resulting in revenues accruing to authorities different from those of the country where the income originates.

- This is also the case for taxes imposed on shareholders of corporations residing in different countries; in effect, taxes on distributed corporate profits are paid by residents of nations other than the tax-imposing ones.

- Corporate tax rates have declined considerably in recent years, reflecting both international competition for investment and supply-side concerns. It is possible that Member States could benefit from an increase in corporate taxation even though none has incentive to act alone. A collectively imposed increase at the level of the EU could serve as a vehicle for such a policy.

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income by European governments made necessary following the liberalization and integration of capital markets in EU.

28 For the diversity of the corporate income tax provisions in several, including some EU, countries in 1994 see Mintz (1996).

29 This is defined in terms of all sales of real goods and services including proceeds from sale of fixed assets, net of purchases of real goods and services and of wages, salaries social security contributions and related charges.

30 See Spahn (1993).

31 See Begg et. al. (1997), p. 26-29.

- There are serious administrative hurdles in operating the tax when multinational firms engage in transfer pricing or thin capitalisation[32] practices. Despite efforts to control such practices, much remains beyond the control of national administrations.

- Different corporate tax systems impair economic efficiency while, with the Single Market, tax competition could lead to resource misallocation.

- With capital mobile and labour immobile, corporate taxes would tend to be borne predominantly by the latter, thus pointing also to assigning the tax to a higher level of authority. Regarding horizontal equity across the Member States, corporate taxation not only reflects poorly contributive capacity but also could lead to substantial distortions in the presence of transfer pricing.

- A corporate tax would not be visible to citizens as consumers but only as owners of firms; as a result, it would not enhance accountability.

- In terms of links to other Community policies, clearly such a tax would advance integration in the context of the Single Market. In addition, as in the case of the CO_2/energy tax, it could help shifting the burden of taxation away from labour, thus contributing to better employment performances.

- Revenues from corporate taxation are notoriously highly cyclical; as an EU resource, it would cause contributions to be variable. Potential revenues from a corporate tax resource would undoubtedly be sufficient[33] and the tax could be administered through the Member States. However, corporate practices could result in significant tax evasion and fraud.

Developing a corporate tax system assigned to the EU would be consistent with the Commission's view that taxes on labour ought to be replaced by taxes on corporations as a means to encouraging employment growth. However, a principal drawback of a new own resource in the form of corporate taxation is the absence of a harmonised base and

32 Thin capitalization refers to the practice where, in order to take advantage of the differential tax treatment of debt and equity in different territories, and in view of the fact that interest on debt enjoys considerable tax relief, firms choose to finance operations through debt rather than equity, so that they shift tax liabilities from the high to low tax territories. A thinly capitalized firm is one whose debt/equity ratio is relatively high. Given the differential tax treatment of corporate income across the Member States, this practice can lead to significant resource misallocation. The term is due to Devereux and Pearson (1989).

33 According to the European Parliament (1990), the proportion of corporate tax revenues accruing to the highest level of government in federal OECD states varies between varies from 30 per cent to over 100 per cent. If the average amount of 64 per cent of corporate tax revenues were to accrue to the EU budget this would generate some Ecu 65 billion in revenues (1988 prices), roughly "double the level of resources now available to the Community"; see European Parliament (1990), part C, p. 21.

the difficulties involved in developing fully such a base. Should the harmonised base be defined differently from the national ones, this could raise administrative, compliance and monitoring costs. The integration of the corporate and the personal tax schedules in some Member States would also make it politically unattractive, although this would not be a concern if the Albi et. al. (1997) / Spahn (1993) proposal were to be implemented. Overall, corporate taxation does not perform well when judged against key criteria for own resources.

Box 4

Corporate income tax

Criteria	*Performance*
Equity	*Corporate taxes levied on profits are generally consistent with equity, although trans-border input purchases and output sales, together with transfer-pricing practices, make allocation of firms' profits to a single Member State difficult. To the extent that production is becoming globalised there is justification for levying corporate taxes at EU level. With an increasing number of firms operating in more than one Member State harmonisation at a higher level of the corporate tax code is appropriate. Multiple corporate tax arrangements are an obstacle to full implementation of the Single Market.*
Base harmonisation	*Virtually non-existent.*
Visibility to taxpayers	*Limited visibility, not to consumers but only to firms. The tax could be presented as a contribution on the part of firms for benefits they enjoy as a result of the completion of the internal market.*
Link to common policies	*Linked to complementing the Single Market.*
Revenue sufficiency, efficiency and cost-effectiveness	*Corporate taxes account for a considerable share of revenues in national budgets and, thus, they are likely to yield sufficient resources. Corporate taxes are very cyclical. Compliance and efficiency costs, which will depend on the definition of the EU and the national tax base, are likely to be substantial.*

3.5. Communications taxation

The proposal to use taxation of communications services as a source of revenue for the EU budget was made by Begg et. al. (1997)[34] in the context of taking advantage of opportunities developing within the internal market. On the one hand, closer integration and market liberalisation have given rise to an increasing volume of activities related to communications; on the other, the presence of externalities favours assigning new taxes to the EU level and, indeed, regulation is shifting in this direction. Arguing also in favour of such taxes is the development of EU policies to improve links among the Member States. The bases for communications taxes are road and air transport and telecommunications services including possibly broadcasting, areas of rapidly expanding economic activities.

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34 See Begg et. al. (1997), p. 43-46.

Begg et. al. (1997) suggest three bases for communications taxation. First, telephones and mobile telephone services; secondly, road transport, an area already suffering from congestion; and, third, air transport, an area where deregulation will boost further growth.

- Road and air traffic congestion suggest the need to price these activities more in accordance with environmental objectives. Increasing integration, following the completion of the internal market, and the expansion of air travel indicate that it is not immediately possible to determine the ultimate base of the tax. Although the tax would belong to a higher level of authority, it would not be possible to determine how each Member State contributes. At the same time, assuming that income is positively correlated with air travel tax, then it would be progressive across individuals.

- Telecommunications services are highly correlated with GNP and, as a result, they are not inconsistent with equity considerations.

- The taxes would not be visible in the case of transport, but more so in the case of air travel; they would be clearly visible in the case of telecommunications.

- The taxes are linked to common policies mainly through transport directives and through initiatives to foster EU competitiveness by modernising transport and telecommunications infrastructure.

- Communications and transport services are already subject to VAT and/or excise duties.

- The base is well defined and harmonisation is already de facto advanced or can be easily accomplished.

- Despite the projected high growth of communications services, it is certain that revenues from this source will be adequate to finance only part of the EU budget. Begg et. al. (1997) estimate that an airport departure tax of Ecu 15 would yield around 10 per cent of the EU budget, while an annual average tax per telephone line of Ecu 40 could finance another 10 per cent of the budget.

- The administrative costs involved in the collection of these taxes would be substantially higher than under the present system; the taxation of communication would involve setting up a family of new own resources and not just one.

It is possible that communications taxes will ultimately militate against long-term progress in competitiveness. A further possible disadvantage is the need to introduce new taxes as well as to change the rates currently charged by Member States. Although politically costly, such measures may encounter objections only during the initial introductory period. There is little to be done on base harmonisation in the case of road transport and air travel but in the case of telecommunications it will be necessary to attain some harmonisation.

Begg et. al. (1997) propose that the communications tax becomes part of a broader set of own resources over the next Financial Perspective, substituting gradually for the diminishing share of traditional own resources in the EU budget. Over the medium term, they see continuing use of these taxes provided that once introduced they prove to function well[35].

Box 5

Communications taxes

Criteria	*Performance*
Equity	*Uncertain whether equity is well served: yes, if road and air transport and telecommunications services are correlated with income; no, if the former are relatively more important in poorer regions. By internalising congestion costs transport taxes could said to belong to the EU level. Moreover, closer trade integration makes it difficult to determine which Member State would be paying the tax on road and air transport activities. Taxes would be paid by both consumers and producers*
Base harmonisation	*Already advanced or can be accomplished rather easily.*
Visibility to taxpayers	*For transport taxes, likely limited; for air travel and telecommunications taxes highly visible.*
Link to common policies	*Consistent with transport directives and with strengthening competitiveness through the TEN initiatives.*
Revenue sufficiency, efficiency and cost-effectiveness	*Given the growth potential of communications services, revenue growth could be buoyant but sufficiency is certainly not assured since only 20% of the EU budget could be expected to be financed through this source. There is also an important cyclical component in such activities. Revenues could be collected easily through existing structures, scope for evasion and fraud rather limited.*

3.6. Personal income tax

Personal taxes constitute the most direct and visible link between taxpayers/citizens and elected authorities. The attraction of imposing surcharges on personal income as the EU's own resources partly rests on the opportunity to exploit this direct link in order to enhance accountability and to contribute towards mitigating the importance of the "democratic deficit". Personal tax constitutes a buoyant source of revenues but its importance differs significantly across the Member States[36]. Steps towards harmonisation of indirect taxation at the EU level leave only personal income taxation

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35 See Begg et. al. (1997), p. 68-71 for a discussion of these issues.

36 According to Eurostat data, taxes on personal income amounted to 23.4 per cent of total tax revenues in 1995, ranging from 16.4 per cent in France to 47.7 per cent in Denmark. In terms of GDP, revenues from taxation of personal income represented 9.7 per cent in 1995, ranging from 7.3 per cent in France to 24.5 per cent in Denmark.

to represent the limited discretionary room for Member States to exercise stabilisation, budgetary and social policy[37].

- There are no externalities favouring assignment of personal taxation to a higher level of authority. The conventional argument for efficient taxation of mobile tax bases does not apply to EU income earners who are currently a highly immobile labour force.

- Income tax rules differ widely between the Member States and the complexity of the income tax schedule in terms of thresholds, personal and family exemptions and allowances poses significant problems for base harmonisation; it is certain that horizontal equity, across individual and Member States, will not be respected under present rules. Moreover, militating against base harmonisation is the very limited mobility of labour in the EU, as a result of which pressures for convergence in income tax rules are very weak.

- There is political opposition to base harmonisation. Moreover, differences in tax and overall economic policies would make it impossible to achieve consensus on these issues. On at least these grounds, personal taxation ought to remain assigned at the national level.

- The visibility of the tax would be particularly high, as would be the link between the financing of the EU and the husbandry of resources made available to the budget; it is certain that accountability would be enhanced.

- There is no direct link between such a tax and other EU policies.

- It is possible that the co-occupancy of the same tax base by national authorities and the EU could complicate the management of national economic and budgetary priorities. As noted previously, the ability to influence stabilisation policy through interventions in the personal tax code would be reduced. Moreover, the balance between direct and other taxes in national tax structure may be adversely affected.

- The tax, depending on its design, can potentially yield sufficient revenues to finance completely the EU budget. However, personal income is highly correlated with the business cycle and revenues could exhibit considerable co-variability with the business cycle although the small share of the EU budget in EU GNP would tend to mitigate the importance of this effect.

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37 For references to the several proposals for an income tax-based EU resource see Begg et. al. (1997).

- There are no major obstacles to revenue collection on the basis of current practices; however, evasion and under-reporting of income for tax purposes is a common problem in several Member States and will remain so in the case of an EU tax.

Begg et. al. (1997) discuss some proposals for designing a new own resource on the basis of personal income tax. A key conclusion is that, with progressivity as a central objective and assuming that 50 per cent of budget expenditure is financed through the progressive resource, the resulting degree of progressivity in the context of *Agenda 2000* may be too sharply pronounced to be politically comfortable[38].

Box 6

Personal income tax

Criteria	*Performance*
Equity	*Differential taxation of various sources of income and interventions in the form of personal and other allowances have led to significant differences in the tax base which, should this become an own resource, would lead to horizontal (across individuals and Member States) inequities. Given the immobility of EU taxpayers/workers, conventional arguments in favour of centralisation of income tax do not apply.*
Base harmonisation	*Non-existent.*
Visibility to taxpayers	*Highly visible tax.*
Link to common policies	*No direct links.*
Revenue sufficiency, efficiency and cost-effectiveness	*Sufficient, generally stable, albeit variable, and likely substantial revenues. Few additional costs in administering the system and collecting tax revenues. Depending on the exact design of the system, it is possible that compliance and avoidance costs would increase.*

3.7. Withholding tax on interest income

Differences in residence and the location of economic activities gives rise to potential avoidance of taxation of income, a case particularly pronounced in flows of interest and dividend income. In practice, differences in the tax treatment of savings and capital income has the potential of allocating capital towards the lowest tax jurisdiction, a possibility that could cause harmful tax competition and could cause serious resource misallocation; taxing at a higher level of authority would limit such resource allocation costs.

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38 See Begg et. al. (1997), p. 23-24; they estimate that on the basis of an EU budget of 1.27 per cent of EU-15 GNP and with 50 per cent of expenditure financed through the progressive resource, Portugal would contribute as little as 0.47 per cent of GNP and Luxembourg as much as 2.07 per cent of GNP and the contribution of the remaining Member States would fall in between these shares.

In the EU, Luxembourg the Netherlands and Denmark are exceptions in that they have no withholding tax. All other Member States - except Belgium, Austria, Finland and Sweden - levy no withholding tax on non-residents. As a result, following the removal of exchange controls, it is possible for foreigners to avoid taxes altogether by using Member States where no withholding tax exists to channel their earnings.

Following an invitation from the Council, the Commission presented a proposal for a Directive to ensure a minimum of effective taxation of savings income in the form of interest payments within the Community on 20 May 1998[39]. The Commission's proposal aims at ensuring a minimum taxation on interest income paid in a Member State to a beneficiary in another Member State. The proposed minimum rate is set at 20 per cent and Member States can choose to levy a higher rate if they so wish. Member States can choose to either apply this withholding tax rate or to provide information on income earned to all other Member States where the beneficiary has his residency (in the commentary on the proposal, this is called the "coexistence model"). As will be seen below, the proposal does not form a promising base for the establishment of a new EU own resource.

- Economic efficiency would argue in favour of assigning the tax to a higher level of authority.

- It is unclear what the equity implications of this tax would be, and there are no immediately available data to evaluate this aspect properly. In principle, the imposition of the tax would not offend the equity criterion given that the level of savings, and wealth, are likely highly correlated with the level of income.

- The tax would be greatly visible to (perhaps a narrow group of) taxpayers.

- Base harmonisation is inadequate. In some cases withholding taxes may be imposed on interest and dividend income earned from investments abroad, in others on income earned from investments abroad and at home, and yet in other cases withholding taxes may be levied on interest but not on dividend income, and vice versa, while the tax treatment of capital gains can be also diverse.

- The Commission's proposal for a minimum withholding tax, while it defines the overall base on which the tax will be levied[40], opens, at the same time, through the "coexistence model", the possibility of shifts between the individual national bases.

- The Commission's proposal for a minimum withholding tax has a strong link to common policies. Since the logic of a withholding tax is directly linked to the

39 See Commission of the European Communities (1998).

40 See Commission of the European Communities (1998), Articles 4 and 5.

liberalisation of capital and financial markets and the removal of exchange controls in recent years, it clearly complements the liberalisation policies by ensuring that capital does not enjoy undue advantage over the immobile factor labour in its tax treatment.

- It is not possible to determine whether sufficient revenues would flow from this tax[41]. Furthermore, interest rate and capital markets fluctuations could make these revenues particularly variable and unpredictable especially in periods of rapid structural change in the financial system as has been witnessed in recent years. It is also possible that financial institutions will develop new instruments to avoid the tax.

Box 7

Withholding tax on interest income

Criteria	*Performance*
Equity	*Because of capital mobility the tax is necessary to ensure symmetric treatment of capital and labour for tax purposes. Although this would suggest assigning the tax to the EU, it is questionable whether it would be consistent with horizontal equity. The level of savings is positively correlated with the level of income, so that this tax could be seen as progressive. However, this at the moment is only a conjecture since there is no data concerning trans-border investment by Member State to evaluate this proposition.*
Base harmonisation	*Incomplete, although progress has been made in this direction.*
Visibility to taxpayers	*Greatly visible.*
Link to common policies	*Linked to the proposed Directive on a minimum withholding tax. It would also be complementing the removal of exchange controls and the liberalisation of capital and financial markets in that it ensures that capital does not enjoy preferential treatment relative to labour.*
Revenue sufficiency, efficiency and cost-effectiveness	*Uncertain revenue, also variable and unpredictable. Collection of the tax by financial institutions is simple and involves no additional compliance costs. Establishing a common minimum tax would require the establishment of a corresponding administrative apparatus for monitoring and compliance purposes.*

The purpose of the Commission's proposal is to prevent harmful competition between national tax systems which could be contributing to the erosion of the tax base in some Member States, to remove tax-induced distortions and to ensure compatibility with the internal market rules. Consequently, the proposal has not been made with a view to exploiting a potential new own resource. Indeed, the proposal offers little promise for founding a new own resource on a withholding tax since, first, it applies only to non-residents who earn interest in a given Member State and, secondly, the "coexistence model" would make it difficult to quantify the base on which the tax would be levied.

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41 One estimate, put forward by Drèze and Malinvaud (1994), section 9.2, p. 98, places potential revenues at 1 per cent of EU GNP or more. This is clearly sufficient to meet a large part of the budgetary needs. However, the authors offer no indication of how they have arrived at this estimate.

3.8. ECB seigniorage

Seigniorage derives from the central bank's monopoly position as note issuer constituting legal tender, the liabilities of which are not remunerated or, in the case of compulsory reserves, they are remunerated at below-market interest rates. These unremunerated liabilities constitute the monetary base, the counterpart of which (holdings of government bonds and of other assets such as foreign exchange reserves) yields interest at market rates. The profits so derived constitute the principal source of central bank revenue. In practice, a tax on seigniorage amounts to a tax on ECB or national central bank profits.

Seigniorage does not accrue directly to the treasury but to the central bank which, in turn, transfers part of its profits to the government. Seigniorage was an important source of government finance in several Member States during years of high inflation and in countries where the financial system was regulated[42]. Since the advent of the convergence process and the sharp decline of inflation in recent years seigniorage has become a very small fraction of the revenue in the budget of virtually all Member States. Moreover, with the establishment of central bank independence in virtually all the Member States in recent years there can be no presumption that the profits of the central bank will automatically accrue to the government. Finally, in future years, according to the rules set out in the Treaty on European Union, seigniorage will accrue to the European Central Bank (ECB) as a result of its note-issuing monopoly position. This revenue will be distributed to constituent central banks according to their capital subscription in the ECB[43] and indirectly to the governments in the Member States. Thus, to make possible the transfer of seigniorage to the EU budget it would be necessary to tax directly the national central bank profits associated with this.

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42 There are many estimates of seigniorage revenues in the literature. See, for example, the estimates reported in Commission of the European Communities (1993a), Table 32, p. 90. Gros (1990) estimates that in 1982 seigniorage amounted to 5.86 per cent of GDP in Portugal but were only 0.80 per cent of GNP in 1993; the corresponding data for Greece are 3.39 per cent and 0.90 per cent; for Italy, 1.45 per cent and 0.75 per cent; for Spain 1.87 per cent and 0.91 per cent; and for Germany, 0.48 per cent and 0.52 per cent; see Gros (1990), Table 7.1, p. 165. See also Rovelli (1994) for additional and more detailed estimates of the sources and role of seigniorage in the public finances of several Member States. Finally, Buiter et. al. (1998), Table 10.1, p. 183, provide the most recent update concerning the role of seigniorage in the public finances of the Member States covering the period 1985 to 1994.

43 See Article 33 of the *Protocol on the Statute of the European System of Central Banks and of the European Central Bank*, Treaty on European Union. This article states that "The net profit of the ECB shall be transferred in the following order: (a) an amount to be determined by the Governing Council, which may not exceed 20 per cent of the net profit, shall be transferred to the general reserve fund subject to a limit equal to 100 per cent of the capital; (b) the remaining net profit shall be distributed to the shareholders of the ECB in proportion to their paid-up shares".

- Seigniorage belongs to the EU level since it derives from the common monetary policy exercised by the ECB on a non-regional scale. In this respect, seigniorage resembles traditional own resources revenues deriving from the exercise of commercial policy through a common external tariff. The issue of equity does not directly arise in the present case. If transactions technology is less advanced in the poorer nations, it is possible that there may be elements of regressivity since seigniorage is a tax on cash holdings. This may be of minor importance, however, as the adoption of the same transactions technology will be widespread under EMU.

- The tax base is completely harmonised, and is defined by the profits of the central bank.

- The treatment of Member States not participating in EMU poses a particular problem for the transitional period. Moreover, for those not joining for an uncertain period of time a way ought to be devised to contribute through a corresponding tax. The necessary arrangements to effectively exploit the potential of seigniorage as an own resource could in this case be complex.

- Seigniorage is not visible to taxpayers.

- Seigniorage as an own resource would be simple to administer, would involve little administration, and would not be subject to fraud and avoidance.

- It is also possible that it may yield considerable revenue for the EU budget. In the steady state seigniorage can be approximated by the tax on nominal balances, or the rate of inflation, and the ratio of holdings of nominal balances to GNP. If price stability is interpreted to mean an inflation rate of between 0 per cent and 2 per cent, and assuming that money holdings amount to around 10 per cent of GNP, seigniorage revenues could amount to between zero and 0.2 per cent of GNP in the EU[44]. However, it is clear that this can be an unreliable and unstable revenue, likely subject to severe shocks emanating from changes in the transactions technology.

A principal drawback of seigniorage is its lack of visibility to taxpayers. Although the underlying source of revenue, inflation, would be very visible, it would convey no information about the costs of the EU and its financing. Finally, with transactions technology making it increasingly possible to hold cash balances in interest bearing assets, the tax base of seigniorage will become very narrow indeed in future years.

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44 As another example, Rovelli (1994) uses a similar framework to estimate potential seigniorage revenues under different combinations of holdings of sight deposits and nominal interest rates (which stand for inflation); he shows that these revenues could range from 0.004 per cent of GDP to as much as 0.3 per cent of GDP; see Rovelli (1994), Table 6, p. 41.

Box 8	
Tax on seigniorage	
Criteria	*Performance*
Equity	*In EMU it will be impossible to allocate seigniorage to Member States.*
Base harmonisation	*Complete; identical in all Member States.*
Visibility to taxpayers	*As an implicit tax, seigniorage is not visible.*
Link to common policies	*Results directly from EMU.*
Revenue sufficiency, efficiency and cost-effectiveness	*Likely to raise considerable revenue which could be particularly unstable since it depends on the demand for cash balances, itself affected by the business cycle. Although price stability in EMU would also ensure a stable base for seigniorage, shocks to transactions technology as well as real income shocks could cause the seigniorage tax base to narrow and could make revenues unreliable and unpredictable. Administration would be extremely simple. It would involve the smallest number of "taxpayers" (national central banks) and compliance and monitoring costs would be negligible.*

4. CONCLUDING COMMENTS

Economic theory provides criteria for the assignment of tax instruments by level of government in a federal context. Once it is determined that certain taxes belong to a higher level of authority, additional secondary criteria can be used to determine the suitability of the tax instruments to serve as own resources for the financing of the EU. The discussion in this Annex has shown that while several taxes can be considered consistent with the economic criteria, they virtually all fail, to one degree or another, to fully satisfy the secondary criteria. Clearly, some taxes perform better than others according to certain criteria but, if it were the case to fully finance the EU budget with new own resources, none fulfils to the necessary degree all criteria.

This is partly a reflection of value judgements on the part of the study about the relative importance of each criterion to be applied in assessing the performance of each candidate resource. Table 1 summarises the assessment of each candidate resource ranked according to the criteria in the three studies cited in the Table and mentioned throughout this Annex.

The ranking is ordinal; 1 indicates the most preferred and 8 indicates the least favoured among the eight candidates; identical marks indicate that the candidates in question perform equally well under the specific criterion. In contrast to the other studies under review, Spahn (1993) finds merits in all proposals without ranking them[45]. It is clear that if, a second-best choice had to be made, possibly a VAT tax version of an own

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[45] See Spahn (1993), especially section 5 (Concluding remarks), p. 580-581.

resource may be attractive; this proposal is ranked first by two of the three studies reported in the Table and it also has the strong support of the European Parliament in the European Parliament (1994) report; as noted previously, the Commission has also supported a CO_2/Energy tax. This lack of consensus is a reflection of more fundamental difficulties at the present state of European integration.

Table 1

Ordinal Ranking of Candidates for New Own Resources in Three Studies

	European Economy[2]	*Begg et. al.*[3]	*Keen*[4]
CO_2/Energy tax[1]	1	6	2
Modulated VAT	3	1	1
Excises on tobacco, alcohol and mineral oil	4	3	4
Corporate income tax	2/3	4	3/4
Communications taxes	-	2	-
Personal income tax	5	5	5
Withholding tax on interest income[1]	4	7	2
ECB seigniorage	2	8	3

- not available; *(1) this does not refer to recent Commission proposals.*

Source: (2) Commission of the European Communities (1993a): op. cit., Table 31, p. 85, line providing an "overall appreciation"; (3) Begg et. al. (1997): op. cit., Table 6.1, p. 51; (4) Keen (1995): op. cit., Table 3.14, p. 81.

It is clear that, while possible, introducing a new own resource will require substantial preparation on the part of all actors involved. However, it is not evident that introducing new own resources on grounds of strengthening financial autonomy alone would suffice. If other, possibly wider political considerations, support it then new own resources could be introduced as part of more fundamental and wide-ranging reforms.

Finally, the present review suggests that it is unlikely to find one tax that alone respects all the criteria to become an EU own resource. A more promising possibility could be that the desirable features of more than one resource will be taken into consideration in order to form the ground for the development of new own resources in the future. This could conceivably involve more fundamental changes in the EU's own resources system of which the introduction of new resources can be only one part.

One possibility, in the medium term, may be to introduce a modulated VAT system with strengthened visibility, much along the lines suggested in the European Parliament (1994) report. Over the long term, where an important objective would undoubtedly be the strengthening of financial autonomy, several alternatives present themselves. The ECB seigniorage, some form of withholding tax on interest income, excises and the communication tax could realistically become own resources provided additional steps towards the integration of the EU took place. Less positive are the prospects for a new own resource based on either corporate or personal incomes. If developments in environment or transport policy called for the introduction of specific taxes in these areas, their yield could be usefully attributed to the EU budget thus contributing to financial autonomy.

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The concept and measurement of the budgetary balance

1. INTRODUCTION

Budgetary balances[1], i.e. the difference between payments made by a Member State to the EU budget and expenditure made by the EU in that Member State, are often seen as a simple way of capturing through a single figure the net financial benefits of being a member of the European Union. The Commission has repeatedly warned against such a simple and misleading approach that fails to capture the real balance of the advantages and disadvantages of belonging to the Union[2].

The present Annex addresses briefly the methodological issues raised by the calculation of budgetary balances. Section 2 examines difficulties associated with the measurement and interpretation of budgetary balances; section 3 discusses alternative measures of budgetary balances based on various definitions of the expenditure and the contributions side; and section 4 explains the two principal definitions – ***operational balance*** and balance à la ***UK rebate*** – used in the report.

2. PROBLEMS WITH THE CONCEPT OF BUDGETARY BALANCE[3]

Budgetary balances, while appealing in their simplicity, either invariably misrepresent or are inadequate measures of the benefits from membership in the EU.

Budgetary flows do not capture all the benefits from membership in the EU. EU membership, which gives rise to financial and non-financial advantages as well as obligations, has a non-budgetary dimension the importance of which dwarfs the budgetary one: For example, the benefits from the pursuit of common objectives, such as trade liberalisation and European economic integration, cannot be evaluated in terms of budgetary flows alone. Moreover, flows from the EU budget invariably benefit not only recipients but other Member States in the form of return flows; typical examples are structural funds and external expenditure, where the implementation of projects often gives rise to purchases of goods and services from other Member States.

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1 Budgetary balances are often referred to as net balances. The term budgetary balances used in this report, in preference to net balances, is more appealing because, first, the concept of a balance is by itself indicative of a difference and, secondly, it is redundant to characterize budgetary positions as net or gross. What the concept is specifically meant to indicate is the difference between contributions to and receipts from the EU budget.

2 These issues were reviewed in detail in Commission of the European Communities (1997): "Budget Contributions, EU Expenditure, Budgetary Balances and Relative Prosperity of the Member States" paper presented by President Santer to the Ecofin Council, October 13.

3 This section is based substantially on the arguments put forward in a 1997 Ecofin paper; see Commission of the European Communities (1997): op. cit., footnote 2, part 4, p. 7-9.

Conventionally measured budgetary balances fail to adequately represent the benefits of EU membership for at least three reasons:

- *first*, recorded budgetary flows fail to account for positive externalities arising from EU policies; for example, CAP, structural operations and external expenditure benefit not only the immediate recipients but also give rise to spill-over effects transcending national borders;
- *secondly*, there are often difficulties associated with the identification of the ultimate beneficiaries of EU expenditure policies. CAP spending on export restitution is an example where expenditure may be recorded as allocated to the Member State from which goods are exported when in fact the ultimate beneficiaries are the producers in other Member States; research expenditure, where multinational consortia ask for EU payments to be made to one member of the consortium or to a bank account opened in Belgium or Luxembourg, also gives rise to similar difficulties; and,
- *thirdly*, EU budget expenditure is heterogeneous and comparisons of total amounts received have often limited meaning in appreciating the "benefit" resulting from such payments. Transfers under the structural operations increase the resources available in recipient countries by the exact amount of the recorded payment (although significant spillovers may result from the ultimate spending of these moneys); on the other hand, payments made for the purchase of goods and services (a large part of administrative expenditure) increase the resources available in the recipient country only for a part of their total amount (the value added generated in the country). Between these two extremes lie different categories of expenditure with different degrees of "benefit" for the recipient that make it difficult to either exclude some items of expenditure or to regroup them in meaningful categories.

3. PROBLEMS OF MEASUREMENT AND INTERPRETATION: ALTERNATIVE DEFINITIONS OF BUDGETARY BALANCES

The present section discusses some important definitional problems that qualify and often undermine the reliability of simple measures of budgetary balances.

To calculate budgetary balances it is necessary to make assumptions about four main issues:

i) the items to be included in the calculation of the payments made by the Member States to the EU budget;
ii) the items to be included in the calculation of the expenditure made by the EU in each Member State;
iii) the use of cash versus accrual data (with the problem of how to account for the carry over of the unspent balances from previous years); and

iv) the possibility of adjusting the resulting set of budgetary balances so that they sum to zero.

On ***payments to the EU budget*** an assumption must be made concerning the most appropriate treatment of customs and agricultural duties (traditional own resources, TOR). There are certainly good arguments for excluding them altogether from the calculations as these contributions result from common policies and they typically belong to a higher level of government rather than to the region or the state that collects them. While this may be formally correct, it is often preferred to find a way of including them so as to mirror the reality of a balanced budget. The inclusion may be done either on the basis of the actual cash flows or by reallocating the total yield of TOR to each Member State according to a given key (e.g. according to shares in EU GNP).

Of interest is the treatment of TOR in the UK rebate mechanism. Given that the calculation of the rebate takes as a starting point the share of the United Kingdom in the combined VAT and GNP payments[4], the mechanism implicitly takes TOR into account but reallocates them among Member States in proportion to their combined VAT and GNP payments (which, as it shown elsewhere in the report, is not very different from re-allocating them according to a straightforward GNP key).

Expenditure made by the European Union in the Member States must, by definition, be lower than total EU expenditure. The expenditure made by the EU in third countries has certainly important spill over effects for the Member States and is often paid directly to EU nationals. However, it would be illogical – as well as nearly impossible from a practical point of view – to attribute it explicitly to any specific Member State. In addition, there are some minor items which, for practical considerations, are also almost impossible to allocate to individual Member States (e.g. transfers relative to the Union's share in the European Investment Fund capital, mission expenditure by EU officials). The remaining expenditure is usually referred to as *allocated expenditure*[5] and represents around 94 per cent of total expenditure.

Whereas there is a broad consensus on the exclusion of the items just mentioned, views differ on the need to make other adjustments. The most contentious issue is the inclusion of administrative expenditure. The arguments for its exclusion rest on the non homogeneity of EU expenditure mentioned at the beginning of this Annex. The subset of allocated expenditure which excludes administrative expenditure is called in

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4 Through the tortuous way of initially calculating the share on the pre-1988 VAT mechanism and subsequently adding or deducting the change with respect to the present mechanism (the so called "advantage to the UK of the new system"; see Annex 4).

5 The definition of allocated expenditure for the UK rebate is established in "Method of Calculation, Financing, Payment and Entry in the Budget of the Correction of Budgetary Imbalances in Accordance with Articles 4 and 5 of the Council Decision on the System of the Communities' Own Resources", Council of the European Union, 5455/94, March 9, 1994, chapter IV.2.

the EU terminology *operational allocated expenditure* [6] and is computed excluding the items found in Part A of the EU budget and spending of other EU Institutions. The definition of budgetary balance measured by this concept of expenditure is called here *operational budgetary balance*.

Some Member States calculate and publish budgetary balance estimates based on an even narrower definition of expenditure that takes into account only the financial flows which transit through the national treasuries (and which are easily identifiable by the Finance ministries). This definition of expenditure excludes not only administrative expenditure but also all the payments that the EU institutions make directly to the final beneficiaries (e.g. research contracts, grants and subsidies under various so called "internal" policies, etc.).

Cash and accruals data are sometimes significantly different. In particular, the need to adjust the VAT and GNP contributions of all Member States and the figures for the UK rebate on the basis of reliable statistical data which become available with a long delay implies that non negligible payments – in both directions – can be made outside the reference year. However, the most important distortion results from the existence of unspent balances from the previous years which show a high variability over time. For instance, in 1995 there was an exceptionally large surplus at the end of the year (Ecu 9.2 billion) which turned out to be more than the double the unspent surplus at the end of 1996 (Ecu 4.4 billion). As a result, on the basis of cash figures, the 1996 budgetary balances of all Member States were higher by a total amount of about Ecu 5 billion due to the fluctuation in the size of the unspent surplus. Such an effect can seriously distort the comparison of the budgetary balance data of different years.

The definition of budgetary balance used in the calculation of the UK rebate eliminates the problem of the unspent surpluses. Since the calculation of the balance is based on the difference between the share in contributions to the EU budget and the share in EU expenditure multiplied by the total amount of EU expenditure, the calculation implicitly assumes that every year the sum of all payments to the EU budget is identical to the amount of EU expenditure.

Constraining the sum of budgetary balances to ***add up to zero*** is often proposed as a way of focusing the debate on the intra-EU distributional issue: what is "paid" net by one country must be "received" net by another. Unadjusted figures, however, will not add up to zero. They should add up to a negative figure equal to the non-allocated expenditure (essentially expenditure made outside the EU). This, it is argued, results in Member States claiming to have transferred to other partners financial resources that have left the EU.

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6 Operating expenditure is defined in Article 19.1 of the Financial Regulation of 21 December 1977 (OJ n° L 356 of 31.12.1997) as the expenditure for policies by the Commission contained in part B of the Budget.

Adjusting budgetary balances to add up to zero can be done in a number of ways which inevitably introduce other distortions and complicate the comparisons of budgetary balances from year to year. The two most widely used methods consist of either reducing contributions to the EU budget to the level of allocated expenditure (while maintaining the relative shares of each Member State constant) or increasing allocated expenditure to match the actual level of payments. The first method implicitly assumes that non allocated expenditure is shared out among Member States in proportion to their contributions to the EU budget; the second assumes that non allocated expenditure is shared out in the same proportion as allocated expenditure. In addition, both methods reduce the overall size of each of the budgetary balances (and the sum of the absolute value of all balances).

The method underlying the calculations for the UK rebate - based on the differences between shares in contributions and shares in expenditure - provides a set of budgetary balances which add up to zero. Implicitly it assumes that non allocated expenditure is shared out in the same proportions as allocated expenditure.

4. THE DEFINITIONS USED IN THE REPORT

Combining only the two or three most important assumptions which can be made on the four issues discussed in the previous section produces no fewer than 30 to 40 perfectly defensible definitions of budgetary balances. While the estimates that emerge from these different definitions do not change substantially the picture for the larger Member States, the use of different definitions can produce substantially different results for the smaller ones and may distort significantly the comparisons from year to year.

In this report the Commission has used two definitions called the *UK rebate budgetary balance* and the *operational budgetary balance*. The first is the only one that has a degree of formal recognition, being based on the Fontainebleau agreement and also in the determination of the UK rebate; the second is consistent with the information the Commission has been supplying to the Member States annually since 1995, albeit on a confidential basis.

4.1. The *UK rebate* balance

This definition uses cash data, i.e. all payments made in a year to or from the EU budget[7]. Its most important implications are:

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7 For the sake of simplicity the calculations have been performed without taking into account the so called "advantage to the UK of the new system" and using cash instead of accruals data.

- TOR payments are implicitly reallocated among Member States in proportion to their VAT and GNP payments;
- the estimates are restricted to sum to zero and the overall absolute size of the balances is reduced by exclusion of those items of expenditure that cannot be allocated (i. e. by about 5 to 6 per cent);
- the data are influenced by the adjustments to contributions relating to previous years but insulated from the fluctuation of the size of the unspent surplus of the current year.
- the expenditure flows taken into consideration are those of the so-called *allocated expenditure*. This means that about 6 per cent of expenditure is excluded (essentially expenditure made outside the Union plus some very small items which, for technical or conceptual reasons, are too difficult to allocate). Included also is administrative expenditure and expenditure in favour of the other EU institutions.

4.2. The *operational* balance

This definition also uses cash data. The most important implications of this definition are:

- The concept of EU expenditure used is *operational allocated expenditure*, that is, allocated expenditure excluding administrative expenditure referred to in part A of the EU budget and expenditure relating to the European Parliament, the Council, the Court of Justice, the Court of Auditors, the Economic and Social Committee and the Committee of the Regions[8];
- TOR payments are considered as paid wholly by the Member State that transfers them to the EU budget;
- the estimates are not restricted to sum to zero;
- the estimates show significant variability because of adjustments relating to previous years and, above all, because of the carry over of the unspent balances from previous years.
- no corrections are made to the expenditure flows which are integrally taken into account.

Ideally, these estimates ought to be presented in a table including a 16th line for the Rest of the World and a 17th line which would correspond to payments to the surplus of the current year and the drawing from the previous year's surplus (with corresponding adjustments to the 15 lines for the Member States) as well as the amount of expenditure corresponding to part A of the budget.

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8 See footnote 6.

The budgetary compensation for the United Kingdom

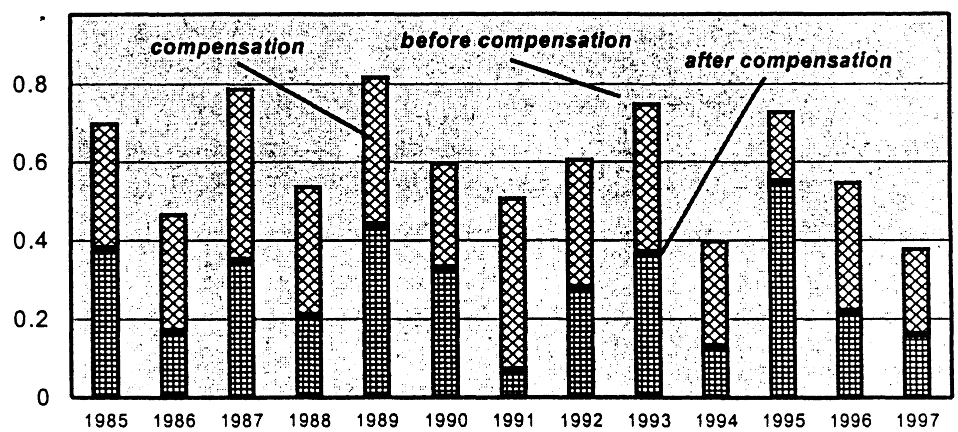
1. INTRODUCTION

This annex reviews the performance of the compensation mechanism for the United Kingdom set up with the 1984 Fontainebleau agreement. It starts by recalling the steps which led to this decision and its contents. Subsequently it reviews the past trend of the budgetary imbalance of the United Kingdom and discusses its possible future evolution in the light of the reform proposals presented by the Commission (*Agenda 2000*). The third section assesses the operation of the mechanism and discusses some issues it raises. The final section examines its consequences for the rate of call of the VAT resource and analyses the possibility of permanently fixing this rate.

Graph 1

Budgetary imbalance of the UK and compensation

("operational" balance before and after compensation; percentage of the GNP of the UK)



2. ORIGIN OF THE MECHANISM

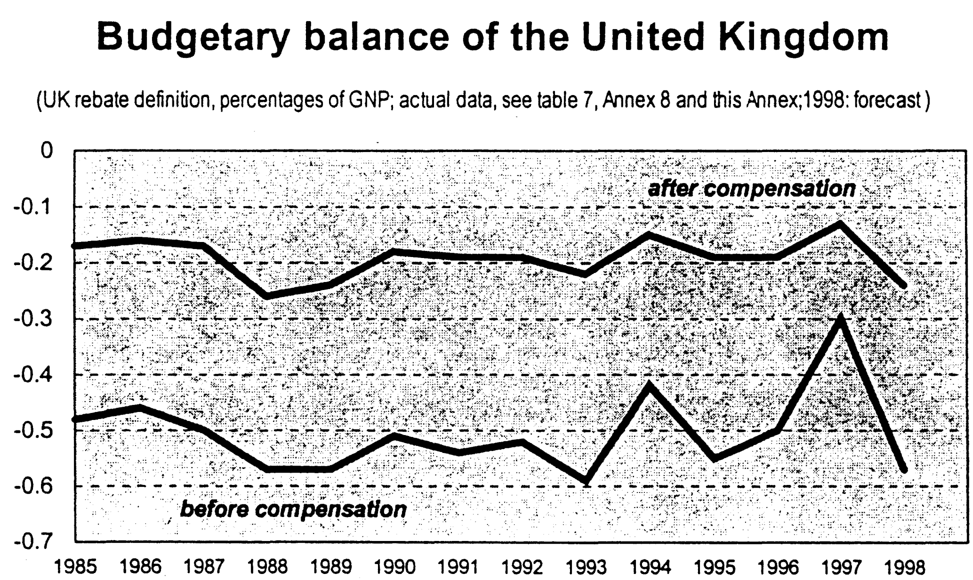
The question of the budgetary imbalance of the United Kingdom appeared immediately after the accession of the country to the European Community. The large imbalance was essentially due to two factors:

i) an agricultural sector relatively smaller and structurally different from those of other Member States, which results in lower CAP spending in the United Kingdom;

ii) a proportionally larger contribution to the financing of the Community budget due to the fact that the United Kingdom has a relatively higher share in the harmonised VAT base than in the total GNP of the Community.

A first mechanism aimed at addressing the issue of the budgetary imbalance of the United Kingdom was agreed in March 1975 in Dublin. This mechanism – known as the *"dynamic brakes"* – aimed at preventing the size of the United Kingdom contribution to the EU budget from becoming too large. The contribution would be capped if three conditions were met simultaneously (GDP per capita lower than 85 per cent of the Community average, rate of economic growth less than 120 per cent of the Community

Graph 2



average, share in own resource payment more than 10 per cent higher than the share in GDP). The three conditions never applied for any Member State and the mechanism was never triggered.

A second arrangement was introduced at another Dublin Council in November 1979. It provided for a compensation on the expenditure side in the form of specific measures for the United Kingdom.

The current mechanism was decided in Fontainebleau in June 1984 and given effect by the Decision of May 7, 1985. This decision contained a transitional arrangement – a reduction of one billion Ecu in the VAT contribution of the United Kingdom for 1985 – and the rules governing the calculation of future rebates, i.e.,

- the contribution of the United Kingdom to the Community budget is reduced by an amount equal to 66 per cent of its budgetary imbalance. This imbalance is calculated by multiplying the difference between the UK's percentage share in VAT payments to the Community budget and its share in allocated expenditure times allocated expenditure (see below). Given that some expenditure (e.g. external expenditure) cannot be considered to have been made for the benefit of any particular Member States, in the calculation of the share of the United Kingdom in the payments made by the Community and in that of the overall imbalance, total Community payments are replaced by the total of all payments that can be allocated to an individual country (usually referred to as *"allocated expenditure"* – see footnote 5 of Annex 3).
- the shortfall in financing is made up by all the Member states in accordance with their respective percentage shares of VAT payments (with the exception of Germany, which pays only two thirds of its normal share, the balance being divided up between the other Member States).

The Own Resource Decision of 1988 modified substantially the system of Own Resources through the introduction of a new resource based on GNP and the reduction in the importance of the one based on VAT. These changes, which went in the direction of reducing the causes of the budgetary imbalance of the United Kingdom, necessitated some adjustments in the compensation mechanism. These were:

i) The calculation of the amount of the refund as if the budget were still fully financed by non-capped VAT (pre-1988 system);

ii) the reduction of the resulting amount of the rebate by the "savings"[1] in its contribution that the United Kingdom derives from the modifications introduced in 1988 (the so called *"UK advantage from the new system"*);

iii) the financing of the UK correction by the other Member States according to their shares in the GNP of the Community. The one-third reduction for Germany was maintained.

3. DEVELOPMENTS IN THE UK REBATE SINCE ITS INCEPTION

There is no clear trend characterizing either the budgetary imbalance of the United Kingdom or the rebate (see graph 1).

All budgetary balances show a high degree of variability for the reasons indicated in Annex 3 (underlying expenditure trends, different rates of economic growth, exchange

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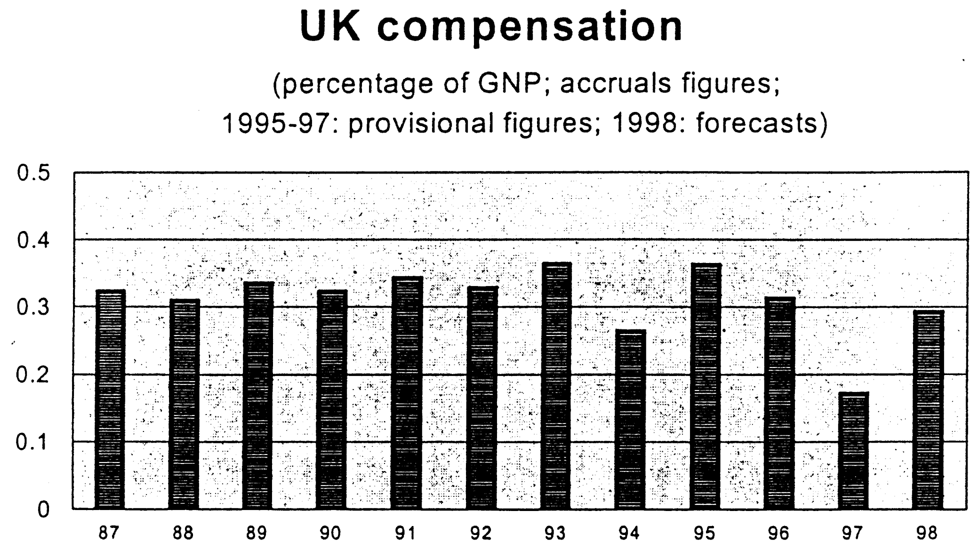
1 These savings are equal to the difference between the amount the United Kingdom pays on the basis of the (capped) VAT and GNP resources under the 1988 system, and what the United Kingdom would have paid under the pre-1988 system (only uncapped VAT).

Graph 3



rate fluctuations, carry over of unspent surpluses from previous years, adjustments for previous years, etc.). The budgetary balance of the United Kingdom, however, shows an even greater variability because of the operation of the correction mechanism itself which foresees the payment of the compensation with a one year lag (an exceptionally large imbalance in one year leads to a large compensation which is paid in the following year, thus reducing further what may have been a normal imbalance, and so on). Furthermore, budgeting rules require that in the budget of year *t* under the heading "UK correction", two different corrections are recorded: the provisional correction for year *t-1* and the definitive correction for year *t-4*. Clearly, the sum of the two corrections has no economic meaning. Table 7 of Annex 8 shows in column (5) the UK correction as reported in the budget in year *t* (that is, the sum of the UK correction for year *t-4* plus the provisional correction for year *t-1*) and, in column (2) the definitive UK correction for year *t-4*.

Budgetary rules also require that, in order to calculate the definitive UK correction for year *t-4*, to construct a UK imbalance on the basis of the GNP, VAT and allocated expenditure outturns for year *t* (that is, four years later). These data permit the estimation of the UK imbalance for year *t-4* shown in column (1) of Table 7, Annex 8. Note also that the imbalance of the UK measured in this manner differs from the imbalances reported in Tables 6a and 6b of Annex 8; the latter are estimated on the basis of GNP, VAT and allocated expenditure outturns as they are known one year after the budgetary year. The use of the definition implicit in the rebate mechanism (graph 2) itself provides a more stable picture as this definition is not influenced by the carry over of the unspent surpluses (see Annex 3).

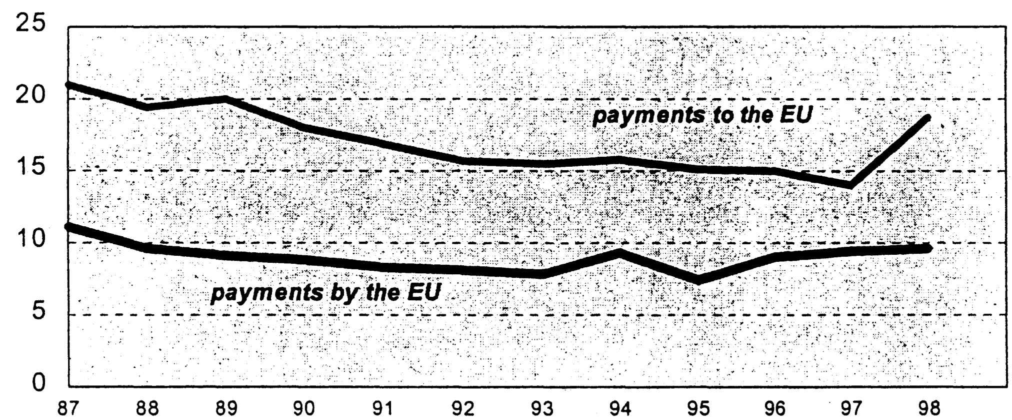
Beyond short-term fluctuations, the budgetary imbalance of the United Kingdom since 1985 has been relatively stable with the imbalance before correction averaging about half a point of the country's GNP. Correspondingly, the amount of the rebate has also remained relatively stable.

Various factors have been at work, which appear to have broadly offset each other. As already indicated, the origin of the budgetary imbalance of the United Kingdom is to be found in two factors: its relative high share of the combined VAT and GNP base on the revenue side, and the low agricultural returns on the expenditure side.

Graph 4

Share of the United Kingdom in (VAT and GNP) payments and in EU (allocated) expenditure

(percentage of totals; accruals figures; 1995-97: provisional figures; 1998: forecasts)



The reduction in the relative weight of the VAT resource brought about by the decisions of 1988 and 1992 should have contributed to a reduction in the imbalance and in the rebate. However, the effect on the rebate was explicitly excluded by the provision which imposed the continuation of its computation on the basis of the pre-1988 system and of the reduction of the result by an amount corresponding to the so-called "advantage" that the United Kingdom was obtaining from the new system. The calculations of this "advantage" done every year show that until now the effect of the changes on the imbalance have been very small. They may have become more significant over the last two or three years in correspondence with the effective reduction of the weight of the VAT resource, but even so their order of magnitude is not large enough to be discernible in the overall trend.

More fundamental changes have taken place on the expenditure side of the EU budget. Agricultural spending, which in 1984 represented about 70 per cent of allocated expenditure, is now down to about 50 per cent. Per se, this change should have contributed to reducing the imbalance of the United Kingdom. However, over the same period, the component of expenditure that grew most rapidly was the Structural Funds. Given the explicit redistributive nature of this type of spending and of its concentration on the so called "cohesion countries", the share of the United Kingdom in total EU spending could not increase. In fact, since 1992 the redistributive component in total EU spending has become stronger.

The factors which have played the greatest role in determining the trend of the rebate – and especially its fluctuations from year to year – have been the difference between the rate of growth of the economy of the United Kingdom and that of the other Member States and the instability of exchange rates. Since the end of the 1980s, the economic cycle of the United Kingdom has been markedly different from that of the rest of the Union. In addition, the pound sterling has fluctuated significantly vis-à-vis the other European currencies between 1992 and 1997.

Underlying expenditure trends have also played a significant role, although in quantitative terms they have been less important and have been overshadowed by macroeconomic developments just mentioned. For instance, in 1994 the United Kingdom was very successful in drawing on structural funds spending and in 1997-98 the BSE crisis led to increased agricultural spending in the country.

Over the next years the imbalance of the United Kingdom (and its compensation) are expected to increase somewhat. This will be essentially the result of the enlargement of the Union to a number of countries that will certainly be net beneficiaries.

4. ASSESSMENT OF THE PERFORMANCE OF THE MECHANISM

The rebate mechanism has been effective in achieving its intended goal: a significant reduction in the United Kingdom's budgetary imbalance. As graph 1 shows, over recent years the negative budgetary balance of this country, after correction, has averaged around 0.2-0.3 per cent of GNP.

However, some of the conditions that prevailed at the time the mechanism was decided do not apply any more:

i) The changes in the composition of EU spending have modified the rationale of the compensation. Whereas in 1984, it had essentially the nature of a correction for the specific agricultural problem (CAP represented about 70 per cent of total allocated expenditure), it has now lost to a great extent this characteristic since it corrects equally the persistent agricultural problem as well as the United Kingdom's contribution to the solidarity effort of the EU and to its other policies.

ii) The budgetary imbalance of the United Kingdom is not unique any longer. In recent years, as graph 5 shows, the imbalance of the United Kingdom, before correction, was the largest of the Community. In 1997, four more countries have budgetary imbalances as large as or even larger than the United Kingdom's.

iii) The gap in relative prosperity between the United Kingdom and the other largest contributors to the EU budget has narrowed. Depending on the measure used, the United Kingdom has a relative prosperity or a relative capacity to pay around the EU average and will certainly be above this mark after the forthcoming enlargement of the EU.

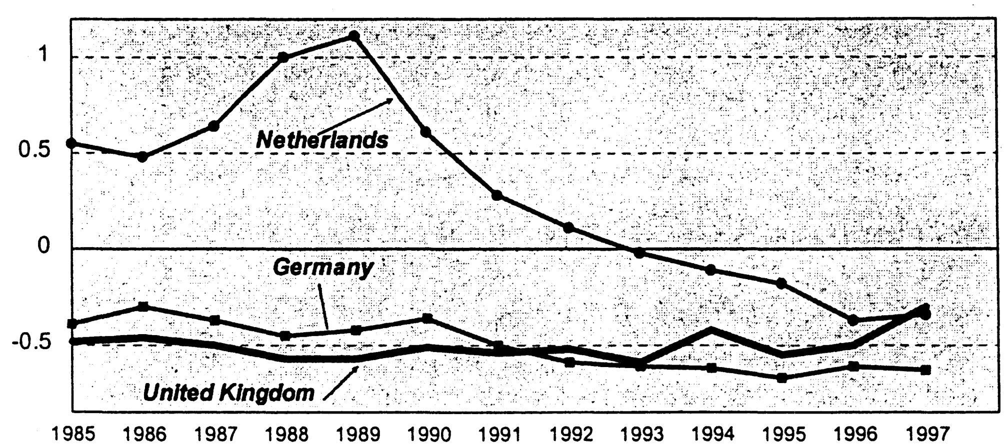
The mechanism has also some drawbacks, which although not new or unexpected, are worth recalling at this stage.

- The existence of the rebate leads to the contribution paid by the United Kingdom representing a lower proportion of its income than those paid by the other Member States. This situation contrasts with the principle of horizontal equity. At the national level, this would be analogous to granting tax relief to individuals who cannot use some public services or who are not recipients of public assistance.

Graph 5

Budgetary balances of the UK, Germany, and the Netherlands

(UK rebate definition; before UK rebate; percentages of GNP)



- The compensation mechanism works as a shock absorber for all changes in the imbalance of the United Kingdom and places this country in a unique position with respect to common budgetary decisions. For example, a budgetary decision that would have a net cost of Ecu 100 to a Member State in fact costs the UK Ecu 33. Conversely, a measure that would improve the balance of another country by 100, improves the balance of the United Kingdom again by only one third of this amount.

This situation, not only risks decoupling the UK from budgetary decision making, but will also have significant adverse effects at the time of enlargement. The accession of a large number of new Member States with very low standards of living is expected to have a negative effect on the budgetary balances of the current Member States. But the United Kingdom will see its budgetary balance deteriorate by only one third of what would have happened in the absence of the correction mechanism. This puts into question a fair sharing out of the burden resulting from enlargement.

- Also in this context, it will be necessary to adapt the definition of allocated expenditure to prevent the United Kingdom from benefiting from purely statistical factors. In effect, at the time of accession of the new Member States some items of present expenditure in these countries (e.g. PHARE) will be replaced by full participation in EU policies. This would lead to their reclassification from external expenditure (excluded from the calculation of the rebate) to internal expenditure (included in the calculation) leading to a mechanical increase in the size of the UK rebate.

- The Commission indicated that it would take into consideration, on the re-examination of the correction system, the opposition of Belgium and Luxembourg to current procedures governing the entry in the accounts and the allocation of administrative expenditure. The position of the Commission was that administrative expenditure could not be treated differently from other expenditure and that it is, therefore, appropriate to include it in the determination of allocated expenditure to any given country. This position was based on the consideration that if it is true that administrative expenditure is, in economic terms, very different from the unrequited transfers typical of the structural funds, there exist various other items of expenditure whose economic nature lays between these two extremes. It would be arbitrary to make a distinction only for administrative expenditure when, for instance, some items of research spending have a very similar nature.

5. THE IMPACT OF THE UK REBATE MECHANISM ON THE RATE OF CALL OF VAT

The rules determining the calculation of the UK rebate and of its financing contain provisions that affect the rate of call of the VAT resource. In 1984, when the mechanism was established, the VAT resource played the role of the complementary resource to be called up on the occasion needed to finance the budget of the Community. It was therefore logical that the rebate be financed according to the share of each country in this resource (with the exception of Germany that was granted a reduction).

The 1988 Own Resources Decision provided for a reduction in the role of the VAT resource and for the introduction of a new one based on GNP. As a result, the role of complementary resource was assigned to GNP and it was decided that the UK rebate would be financed according to the share of each country in this new, more equitable, resource.

However, the shares of the Member States in the VAT and GNP bases are not equal and the introduction of the GNP resource favoured some countries relative to others. The countries which desired to reduce further the role of the VAT resource, failing to obtain a reduction in its maximum call rate, obtained some reduction indirectly through the UK rebate mechanism. It was, in effect, decided to calculate the amount of VAT theoretically necessary to finance the UK rebate and not to call a corresponding amount of VAT[2].

The provisions of the *Mode de Calcul*[3] determine an amount (called the *"gross equivalent"* and which is actually larger than the UK rebate) that must be left aside for the notional financing of the UK rebate. The percentage of the total EU VAT base necessary to generate this amount (called the *"frozen rate"*) is deducted from the maximum rate foreseen in the Own Resources decision to obtain the yearly rate of call. This rate of call changes every year depending on the size of, and shows the same high variability as, the UK rebate.

This situation generates additional complications every time the amount of the UK rebate is revised[4]. An upward or a downward revision of the UK rebate provokes a change in the opposite direction of the rate of call of VAT and in the amount to be called (or that should have been called). Given that the size of the budget to be financed remains the same, a change in the amount of VAT called must be compensated by a corresponding change of opposite sign in the amount of GNP called. Since Member States have different shares in the bases of the two resources, these changes are not neutral (this effect of the rebate on the VAT and GNP contributions of the Member states is usually called the *"indirect effect"*). If the amount of the UK rebate must be revised, it becomes necessary to compensate Member States for the incorrect amount of the VAT and GNP contributions that have been called. This calls for complicated calculations for each revision of the UK rebate and its budgeting in two different chapters (Chapter 15 and chapter 35) which produces the somewhat surprising result that the United Kingdom appears to participate in the financing (albeit for very small amounts) of its own rebate.

In 1992, the Commission argued forcefully that the same reduction in the role of the VAT resource could be obtained through a straightforward reduction in the maximum call rate equal to the average frozen rate of the last years. The maximum rate of call was indeed reduced from 1.4 in 1994 to 1.00 per cent in 1999, but the notional financing of

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2 See Article 5 of the Council Decision 88/376/EEC, Euratom on the system of the Communities' own resources, June 24, 1988; *Official Journal of the European Communities* L 185, July 15, 1988.

3 See "Method of Calculation, Financing, Payment and Entry in the Budget of the Correction of Budgetary Imbalances in Accordance with Articles 4 and 5 of the Council Decision on the System of the Communities' Own Resources", Council of the European Union, 5455/94, March 9, 1994.

4 This is done at least twice during the budgetary process, once in the first supplementary amending budget of the year in which the rebate is paid and three years later when the final calculations are made.

the rebate through VAT (with its *"gross equivalent"*, *"frozen rate"*, *"indirect financing"* and two budgetary chapters) has remained.

The Commission hopes that on the occasion of a revision of the Own Resources Decision it will be possible to suppress these unnecessary complications. Over recent years the amount frozen for the notional financing of the rebate has averaged 0.12 per cent of the total EU VAT base.

❖ ❖ ❖

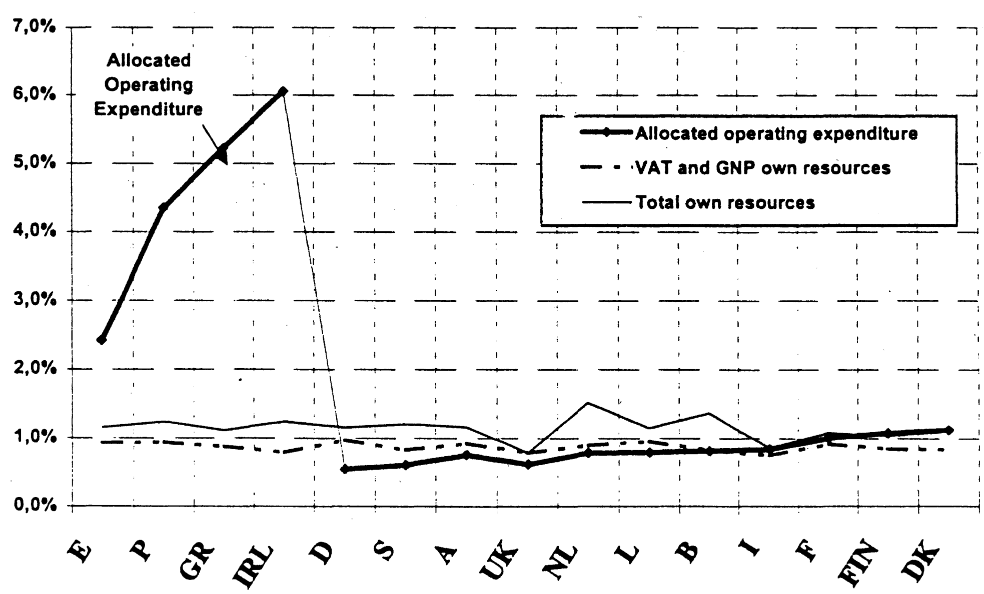
The effects of a partial reimbursement of CAP direct aids

1. INTRODUCTION

The budgetary imbalances which have emerged in recent years are fundamentally due to the structure of the expenditure rather than to the revenue side of the EU budget (see Graph 1 and table 1). As underlined on several occasions in the report, gross contributions to the EU budget are broadly equitable, and are expected to become more so in coming years as the weight of GNP resource increases and that of the VAT resource diminishes. The principal source of imbalances is the expenditure side of the EU budget. Graph 1 shows that while VAT and GNP contributions respect a proportional relationship with the Member States' GNP, EU expenditure bears no relations to GNP.

Graph 1

Allocated *operating* expenditure, VAT and GNP own resources payments (before UK correction) **and total own resources payments, 1997 (as percent of national GNPs)**



The uneven distribution of EU spending across the Member States is the result of deliberate policy decisions. Some 85% of EU spending is concentrated in two main categories of expenditure: Common Agricultural Policy (CAP) and Structural expenditure. While it is clearly incoherent to interfere with the budgetary outcomes resulting from Structural expenditure, it is conceivable to intervene in the area of CAP spending. Section 2 of this annex examines a possibility which has been put forward recently of modifying the financing of direct aids to farmers, and section 3 illustrates the effect of such a modification on the budgetary balances of the Member States on the basis of results from a representative simulation.

Table 1

Member States' shares in EU financing and in spending under the CAP and structural operations, 1997

(percentage shares in EU total, cash data)

	B	DK	D	GR	E	F	IRL	I	L	NL	A	P	FIN	S	UK
Financing															
Total	**3.9**	**2.0**	**28.2**	**1.6**	**7.1**	**17.5**	**0.9**	**11.5**	**0.2**	**6.4**	**2.8**	**1.4**	**1.4**	**3.1**	**11.9**
➢ *VAT/GNP*	*3.1*	*2.0*	*29.1*	*1.7*	*7.7*	*19.0*	*0.8*	*12.3*	*0.2*	*5.1*	*3.0*	*1.5*	*1.5*	*3.2*	*9.6*
➢ *TOR*	*7.4*	*2.0*	*24.2*	*1.1*	*4.5*	*10.9*	*1.6*	*7.9*	*0.2*	*12.2*	*1.8*	*1.1*	*1.0*	*2.6*	*21.5*
Spending															
Total (1)	**2.5**	**2.2**	**14.2**	**7.8**	**15.8**	**17.1**	**4.7**	**11.8**	**0.2**	**3.5**	**1.9**	**5.3**	**1.5**	**1.7**	**9.9**
➢ *CAP*	*2.4*	*3.0*	*14.2*	*6.7*	*11.3*	*22.5*	*5.0*	*12.5*	*0.1*	*4.3*	*2.1*	*1.6*	*1.4*	*1.8*	*10.8*
➢ *Structural Operations*	*1.4*	*0.7*	*14.0*	*10.2*	*24.5*	*9.4*	*4.7*	*11.1*	*0.1*	*1.6*	*1.4*	*11.3*	*1.5*	*0.9*	*7.4*

(1) Total operational expenditure (net of administrative expenditure).

2. A PARTIAL REIMBURSEMENT OF CAP DIRECT AIDS TO FARMERS

CAP spending consists essentially of expenditure to support market prices and of direct aids to farmers. Market expenditure, which is allocative in nature, aims at redistributing income from consumers towards the farm economy. Direct aids to farmers are intrinsically a redistributive policy that transfers income to farmers from the taxpayers at large[1]. It is has been proposed that this last type of expenditure be partly financed by the Member States concerned. Member States would continue to pay direct aids on the basis of Community legislation as at present, but instead of receiving a 100 per cent reimbursement from the EU budget they would receive only a partial one. The rationale for the partial reimbursement would be that direct aids to farmers constitute strict interpersonal redistribution, with no allocative aim. According to the subsidiarity principle, interpersonal redistribution is better implemented at the level of Member States rather than at the level of the EU.

If implemented, this option would be consistent with and would represent a generalisation of the principles currently governing Structural Funds expenditure. In this area, there is already a system for sharing the financial burden between the

[1] The overall redistribution induced by the CAP is greater than the reported budget costs. According to the OECD, in 1990 the transfers to farmers associated with the CAP were equivalent to Ecu 64 billion consisting of Ecu 50 billion from consumers and Ecu 14 billion from European taxpayers; see OECD (1990): *Agricultural Policies, Markets and Trade Monitoring and Outlook*, Paris.

Community and national exchequers since Member States are required to match EU spending.
Proponents of such a modification of current CAP arrangements stress that it should not be seen as a dismantling of the CAP or a move towards its re-nationalisation. Farmers would receive the same support since CAP expenditure by Member State is compulsory. The level and the conditions attached to the payments of these direct aids would continue to be an integral part of the Common Agricultural Policy and would be determined only through EU decisions. The overall amount of financial resources available would also remain the same, but would be shared between the EU budget and the national exchequers.

A partial reimbursement of direct aids along these lines while not reducing the overall amount of spending would reduce the amount of financial resources channelled through the EU budget. For instance, if such a measure were introduced from next year and the level of partial reimbursement was set at 75 per cent, the level of payments appropriations of the EU budget in 1999 could be automatically reduced by about 8 per cent. Given that the shares of individual Member States in the financing of the EU budget and in direct aids spending are very different, a reduction in the part of this expenditure to be financed through the common budget will influence their budgetary balances. Table 2 presents the relevant figures: the shares of each Member States in total GNP, which is equal to its share in the marginal financing of the EU budget, and the shares in spending for direct aids. Given the importance of the current reform for the amount of direct aids the table presents also figures for 2006; these are calculated on the assumption of full implementation of the proposals that the Commission presented on 18 March 1998.

Table 2

Member States' shares in total GNP and in direct aids spending
(percentage shares in the EU-15 total)

B	DK	D	GR	E	F	IRL	I	L	NL	A	P	FIN	S	UK
GNP 1999 / 2006 (1)														
3.0	2.0	25.3	1.4	6.7	17.0	0.8	14.0	0.2	4.5	2.5	1.3	1.4	2.8	17.1
Spending for direct aids in 1999														
1.1	2.9	15.2	7.9	14.3	23.9	2.3	12.6	0.1	1.3	1.7	1.5	1.0	1.9	12.3
Spending for direct aids in 2006														
1.7	3.0	17.4	6.3	12.3	23.7	2.9	12.2	0.1	2.6	2.0	1.5	1.2	2.0	11.0

(1) based on the assumption that all Member States will experience the same rate of growth and the same rate of inflation.

All the Member States presenting large budgetary imbalances have a share in financing higher than the share in direct aids receipts and would therefore see a reduction in their imbalance if such a measure were implemented. For this reason, a partial reimbursement of CAP direct aids can be seen as a way of defusing the issue of the budgetary imbalances; moreover, this policy would be consistent with the Fontainebleau principles which stressed that the preferred way to address any budgetary imbalances was through the expenditure side of the budget.

From the administrative point of view, the option of a partial reimbursement would be very simple and would entail no additional costs. In addition, the decision could be taken under the same voting procedures used to modify the CAP and would therefore be easier to put into practice than any solution requiring a modification of the Own Resources decision. Should a measure of this type be adopted, it would be appropriate to lower correspondingly the agricultural guideline to maintain its effectiveness. It would also be necessary to lower the own resources ceiling. If a revision of the Own Resources decision were not possible, it would be necessary to find a sufficiently strong form of engagement not to use the margins liberated by the reduction in CAP spending.

3. EFFECTS OF A REIMBURSEMENT LIMITED TO 75 PER CENT OF EXPENDITURE

To give an idea of the quantitative impact of the introduction of a partial reimbursement this section presents the results of a simulation based on the assumption that Member States would receive a reimbursement equal to 75 per cent of the expenditure incurred. In 1999, agricultural expenditure under Heading 1 of the Financial Perspective, excluding the monetary reserve, should amount to Euro 40.4 billion (at current prices).[2] of which 27.9 would be due to direct aids. Under the assumption of 75 per cent reimbursement, Member States would have to finance directly about Euro 7 billion and the size of the EU budget would be reduced correspondingly. However, if the proposal of the Commission for the reform of the CAP were implemented, by 2006 direct aids spending would reach Euro 36.6 billion (current prices) and, if the partial reimbursement option were implemented, Member States would have to finance Euro 9.15 billion.

Tables 3 (data for 1999) and 4 (data for 2006) illustrate the financial consequences on the budgetary balances of each Member State of such a measure[3]. To allow a correct appreciation of the impact of the modification, the data are presented before the application of the UK correction mechanism. The first two columns of the tables show the amounts of direct aids spending that Member States would have to finance directly. These amounts would have to be entered into the national budgets and would increase correspondingly national spending. At the same time, however, the national contributions to the EU budget would be reduced by the amounts indicated in columns (3) and (4). The overall net effects of the measure are shown in columns (5) and (6). A positive (negative) figure indicates an improvement (deterioration) in the budgetary balance relative to the current situation. The same results are presented in Graphs 2 and

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2 Preliminary Draft Budget of the European Union for the financial year 1999, COM (98) 300.

3 The simulation is based on the assumption of a linear partial reimbursement, i.e. irrespective of the product. All other CAP rules would remain unchanged. This means that market support expenditure would continue to be integrally reimbursed to Member States. Export refunds, market intervention expenditure, storage costs, promotion measures and other minor items, such as monitoring and preventative measures would not be covered by this proposal, as they do not constitute expenditure paid directly to farmers. Finally, those type of agricultural expenditure which are already co-financed, such as rural and accompanying measures and some other income supports, are also excluded from this proposal, as they would lead to supplementary national co-financing beyond the level which is agreed upon for structural operations.

3 where the Member States are ranked from that with the largest improvement in the budgetary balance to that with the largest deterioration, in absolute terms (Graph 2) and as a percentage of GNP (Graph 3).

Table 3

Implications of a partial reimbursement (75%) of CAP direct aids

(Year 1999, in Euro million and in percent of GNP, at current prices, before UK correction)

	National financing Share in CAP direct aid payments [1]		EU budget financing Share in the GNP resource [2]		Difference	
	Euro million	Percent of GNP	Euro million	Percent of GNP	Euro million	Percent of GNP
	(1)	(2)	(3)	(4)	(5)	(6)
B	77.8	0.03	208.6	0.09	**130.9**	**0.06**
DK	201.3	0.13	138.5	0.09	**- 62.8**	**- 0.04**
D	1 057.8	0.05	1 762.0	0.09	**704.3**	**0.04**
GR	551.5	0.50	99.2	0.09	**- 452.3**	**- 0.41**
E	993.5	0.19	463.7	0.09	**- 529.8**	**- 0.10**
F	1 663.0	0.13	1 184.5	0.09	**- 478.5**	**- 0.04**
IRL	163.0	0.26	56.4	0.09	**- 106.6**	**- 0.17**
I	877.3	0.08	972.7	0.09	**95.4**	**0.01**
L	3.8	0.02	14.8	0.09	**11.1**	**0.07**
NL	90.3	0.03	315.9	0.09	**225.6**	**0.06**
Ö	120.5	0.06	175.6	0.09	**55.1**	**0.03**
P	106.5	0.11	87.8	0.09	**- 18.7**	**- 0.02**
SF	72.0	0.06	100.5	0.09	**28.5**	**0.03**
S	134.8	0.06	191.7	0.09	**56.9**	**0.03**
UK	854.0	0.06	1 194.8	0.09	**340.8**	**0.03**
Total	**6 966.8**	**0.09**	**6 966.8**	**0.09**	**0.0**	**0.00**

(1) Determined according to the projected CAP refunds for each Member State in 1999; (2) determined according to the share of each Member State in EU GNP (Preliminary Draft Budget 1999).

The results presented in tables 3 and 4 are not surprising and correspond to what could have been derived from a simple inspection of the figures of table 2: the relatively large beneficiaries of CAP spending see a deterioration of their budgetary balances while the five Member States with the largest imbalances would experience an improvement.

Two elements need be underlined. The first is that the operation of the correction mechanism will reduce by two thirds the gains of the United Kingdom that appear in the tables with corresponding small improvements for the other Member States (in most cases small enough not to change the figures expressed as a percentage of GNP). The second is that in 2006 the new Member States would see a significant improvement in their budgetary imbalance since they would see a reduction in their contributions made possible by the lower amount of CAP spending which would not be offset by any increase in spending at the national level (direct aids are not foreseen for these countries).

The results of this simulation are proportional to the initial assumption and can be extrapolated to different assumptions about the rate of partial reimbursement (e. g. a rate of national co-financing fifty per cent higher would give changes in the budgetary balances which would also be fifty per cent larger).

Table 4

Implications of a partial reimbursement (75%) of CAP direct aids

(Year 2006, in Euro million and in percent of GNP, at current prices, before UK correction)

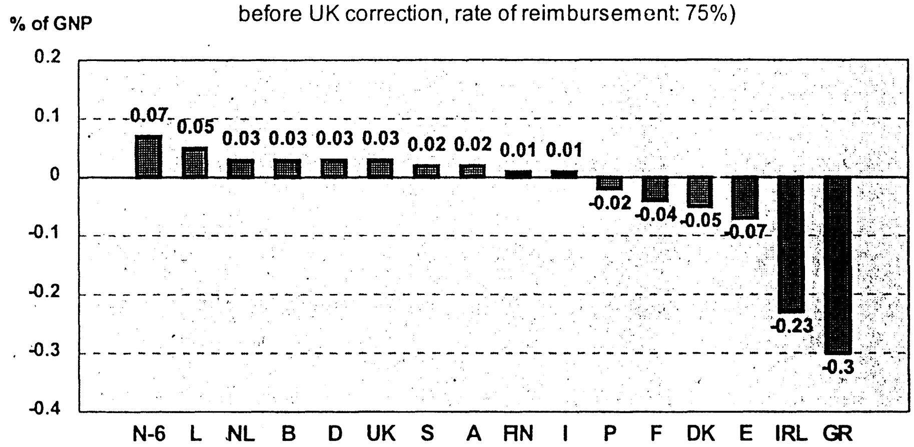
	National financing Share in CAP direct aid payments [1]		EU budget financing Share in the GNP resource [2]		Difference	
	Euro million	Percent of GNP	Euro million	Percent of GNP	Euro million	Percent of GNP
	(1)	(2)	(3)	(4)	(5)	(6)
B	157.4	0.05	268.1	0.08	**110.7**	**0.03**
DK	278.7	0.13	178.1	0.08	**- 100.6**	**- 0.05**
D	1 586.6	0.06	2 264.8	0.08	**678.2**	**0.03**
GR	579.5	0.38	127.8	0.08	**- 451.7**	**- 0.30**
E	1 123.7	0.16	595.5	0.08	**- 528.2**	**- 0.07**
F	2 169.7	0.12	1 521.2	0.08	**- 648.5**	**- 0.04**
IRL	268.4	0.31	72.6	0.08	**- 195.8**	**- 0.23**
I	1 115.2	0.07	1 249.7	0.08	**134.5**	**0.01**
L	7.5	0.03	19.1	0.08	**11.6**	**0.05**
NL	237.2	0.05	406.0	0.08	**168.8**	**0.03**
Ö	181.9	0.07	225.7	0.08	**43.8**	**0.02**
P	136.6	0.10	112.8	0.08	**- 23.9**	**- 0.02**
SF	106.3	0.07	129.1	0.08	**22.8**	**0.01**
S	185.9	0.06	248.2	0.08	**62.3**	**0.02**
UK	1 010.7	0.06	1 440.3	0.08	**429.6**	**0.03**
New 6	0.0	0.00	286.4	0.08	**286.4**	**0.07**
Total	**9 145.3**	**0.08**	**9 145.3**	**0.08**	**0.0**	**0.00**

(1) Determined according to the projected CAP refunds for each Member State in 1999; (2) determined according to the share of each Member State in EU GNP; the underlying macro-economic assumptions are those in European Commission (1998), (COM(1998)164 final, p.2).

Graph 3

Effects on the budgetary balances of a partial reimbursement of CAP direct aids

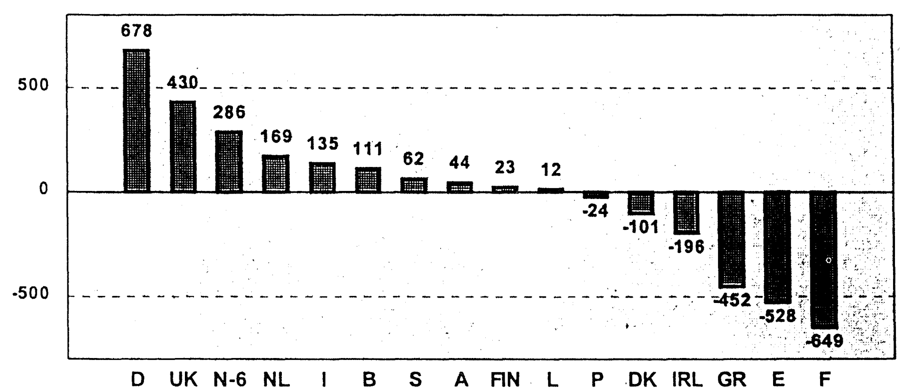
(Differences from present system, data refer to 2000 *percentage of GNP*, before UK correction, rate of reimbursement: 75%)



Graph 2

Effects on the budgetary balances of a partial reimbursement of CAP direct aids

(Differences from present system, data refer to 2000 *in Euro millions*, current prices, before UK correction, rate of reimbursement: 75%)



A generalised budgetary compensation mechanism: Evidence from simulations

1. INTRODUCTION

The emergence of what some Member States consider as large negative budgetary balances in recent years has led Ministers of Finance from Germany, the Netherlands, Austria and Sweden to write to the President of the Commission putting forward proposals for granting budgetary corrections, in a non-discriminatory manner, to all Member States that qualify[1].

This Annex reviews the generic proposal made by these four countries and provides estimates of its implications for the EU budget and for the distribution of the financing burden across the Member States. Section 2 of the Annex presents the proposal; section 3 examines an unconstrained scenario where a simple extension of the UK rebate is granted to other Member States; section 4 reviews a scenario where a modified version of the generalisation of the UK rebate along the line proposed by these four Member States is assumed to be applied; this scenario involves essentially a partial compensation of the excess of the measured negative budgetary balances above a pre-determined threshold; and, finally, section 5 presents a graphical summary of the results.

2. A PROPOSAL TO GENERALIZE THE UK CORRECTION MECHANISM

Minister Waigel submitted to the President of the European Commission on March 5, 1998 a proposal with the view to correcting the perceived large budgetary imbalance of Germany. In subsequent days, the Austrian, the Dutch and the Swedish Finance Minister also wrote to President Santer with virtually identical proposals favouring the introduction of such a correction mechanism.

Minister Waigel's proposal is based on the Conclusions of the Fontainebleau European Council of 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"*[2]. The Minister argues that while initially this principle benefited only the UK, it should now form the basis for introducing a generalised correction mechanism to benefit those Member States experiencing disproportionate budgetary imbalances. Accordingly, the proposal is intended

- to be non-discriminatory, by being available to all eligible Member States;

1 See the discussion in part 2 of the report.

2 See Fontainebleau European Council, Conclusions of the Presidency, Bulletin of the European Communities 6-1984.

- to take into account each Member State's capacity to pay[3];
- to correct not all but only those budgetary imbalances considered as excessive (in order to respect the fundamental policy decisions on the expenditure side of the budget);
- to foster budgetary discipline for both net contributors and net beneficiaries;
- to be sufficiently flexible to facilitate the achievement of fair solutions.

The precise framework of the proposed correction mechanism is defined as follows:

*Amount of compensation = (Net burden – threshold) * coefficient of compensation*

Three parameters determine the amount of compensation. First, the budgetary position or ***net burden***, secondly, the ***threshold*** beyond which compensation applies and, third, the ***coefficient of compensation***. The first two variables are measured in current Ecu, and the third in percentage points.

It is suggested that the budgetary balance, or ***net burden***, be calculated in accordance with the UK correction mechanism[4].

The ***threshold*** beyond which compensation applies is a measure of the maximum solidarity among the Member States and can be determined as a function of the relative prosperity of the Member State in question. In the proposal under review, only a part of the budgetary imbalance will be corrected, that is, the excess of the budgetary position above a pre-determined threshold value. In the case of the UK rebate this threshold is zero, that is, the total of the budgetary imbalance is used as the base for the estimation of the compensation. In the most general form of the proposal, the threshold can vary from one case to another.

Finally, the amount of compensation is determined by the ***coefficient of compensation***. The coefficient will be bound in the range between greater than zero and less than or equal to one. In the case of the UK rebate, the coefficient is 0.66. In the proposed scheme, alternative values of this coefficient are also conceivable. The threshold and the coefficient constitute the flexible parameters of the proposed mechanism[5].

The proposal does not specifically deal with the issue of the ***financing*** of the rebates that are granted. In the present system, the UK does not finance its own rebate. A

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3 In the original: "Leistungsfähigkeit".

4 The Commission has argued on several occasions that there is no single best definition of the concept of net burden and Annex 3 of the present report deals specifically with this point. Clearly, if the proposed mechanism is to be a generalisation of the current UK correction, it seems logical to apply the same procedure and to use the same concept of net burden that has been used in the last 15 years for the calculation of the UK correction.

5 In sections 3 and 4 of the Annex two simulations, that differ according to the threshold used but have the same coefficient of compensation (0.66), have been prepared. The threshold determines which Member States are eligible for the rebate and which are not, while the coefficient of compensation is a simple arithmetic factor which scales the magnitude of the results (e.g. using a coefficient of compensation equal to 0.33 one would obtain results which are half of those obtained by using 0.66).

straightforward extension of the present model could be seen as implying that the Member States benefiting from the system should not finance their own rebates. However, this solution would not only be very costly in a situation where many Member States benefit from the system, but is also fraught with risks. In particular, a *threshold effect* could appear whereby a country with a negative balance just exceeding the threshold would receive a (small) rebate, but would be exempted from the burden of financing the rebate of others. A small difference between the net burden of two Member States before application of the mechanism could be converted into a much larger once the correction has been applied. It appears coherent, therefore, to assume that a Member State should not finance its own rebate, but that it should finance all the others. This would eliminate any unwanted "threshold effect".

Eliminating the *threshold effect* also helps to reduce (but not to eliminate) the *second round* problem. This refers to Member States that are below the solidarity threshold before the mechanism is applied but find themselves above after the mechanism as a result of their participation in the financing of the other Member States' rebates. The simulations in the following sections are calculated without taking into account possible *second round* effects which – while eliminating possible inequities arising from the mechanism - would lead to an additional increase in complexity and a further diminishing of transparency in the EU budgetary relationships.

As in the UK rebate, it is proposed that the compensation should be financed according to the respective share of each Member State in EU GNP[6].

3. AN UNCONSTRAINED GENERALIZED CORRECTION MECHANISM [7]

This section examines the cost and financing implications of a generalisation of the current UK rebate system to all Member States presenting negative budgetary balances. In this case, the *threshold* is set to zero and the *coefficient of compensation* to 0.66. Member States participate in the financing of all rebates except their own according to their share in EU GNP.

The definition of the net burden is an important element in the exercise since the cost of the mechanism depends on how the budgetary balance is defined. For purposes of illustration the concept used here is the same as in the UK correction mechanism[8].

6 In these simulations, a reduction of Germany's share in the financing of the UK correction, as laid down in Article 5 of the Own Resources Decision, is ignored. Therefore, it is assumed that Germany would participate in the financing of the rebates of all other Member States eligible for compensation, according to its actual share in EU GNP.

7 The Court of Auditors in its recent special report on the own resources system has presented some evidence, for the year 1996 on the implications of an unconstrained generalized correction mechanism. See European Court of Auditors (1998): *Rapport spécial no. 6/98 relatif au bilan du systéme des ressources fondées sur la TVA et le PNB*, June and *Official Journal of the European Communities* C 241, July 31, 1998. The Court's evidence is mentioned in section 3.27 of the report. The present Annex extends and qualifies the Court's results for 1999. It is clear that an unconstrained generalized correction mechanism is not the system proposed by the ministers of Finance of Germany, Austria, the Netherlands and Sweden.

Table 1

Implications for budgetary balances of an unconstrained generalised correction mechanism

Projections for 1999; "UK rebate" balance [1] (data in Euro million and in % of GNP)

	Budgetary balance "à la UK correction" (before UK correction)		MS eligible for a rebate	Amount of compensation	Financing	Total redistributive effect (4) + (5)	New budgetary balance	
	Euro million	% of GNP	Threshold 0,0% of GNP	Coefficient 0,66	GNP share	Gains/losses from the mechanism	Euro million (1) + (6)	% of GNP
	(1).	(2)	(3)	(4)	(5)	(6)	(7)	(8)
B	2 131,7	0,92	0,0	0,0	- 538,9	- 538,9	1 592,7	0,68
DK	188,8	0,12	0,0	0,0	- 357,7	- 357,7	- 168,9	-0,11
D	***-9 804,8***	***-0,50***	***-9 804,8***	***6 471,2***	***-2 361,1***	***4 110,1***	***-5 694,7***	***-0,29***
GR	5 221,0	4,71	0,0	0,0	- 256,4	- 256,4	4 964,6	4,48
E	8 006,8	1,55	0,0	0,0	-1 197,8	-1 197,8	6 808,9	1,32
F	- 516,8	-0,04	- 516,8	341,1	-2 990,1	-2 649,1	-3 165,8	-0,24
IRL	2 570,4	4,08	0,0	0,0	- 145,7	- 145,7	2 424,6	3,85
I	- 649,5	-0,06	- 649,5	428,6	-2 443,1	-2 014,5	-2 664,0	-0,25
L	717,8	4,33	0,0	0,0	- 38,3	- 38,3	679,5	4,10
NL	***-1 342,0***	***-0,38***	***-1 342,0***	***885,7***	***- 773,9***	***111,8***	***-1 230,2***	***-0,35***
A	***- 770,2***	***-0,39***	***- 770,2***	***508,4***	***- 440,5***	***67,9***	***- 702,3***	***-0,36***
P	3 173,1	3,24	0,0	0,0	- 226,7	- 226,7	2 946,4	3,01
FIN	- 124,9	-0,11	- 124,9	82,4	- 258,4	- 176,0	- 300,9	-0,27
S	***-1 001,6***	***-0,47***	***-1 001,6***	***661,1***	***- 476,5***	***184,6***	***- 817,1***	***-0,38***
UK(2)	-7 799,8	-0,58	-7 799,8	5 147,9	-2 021,0	3 126,9	-4 672,9	-0,35
TOTAL	**0,0**	**0,00**	**-22 009,6**	**14 526,3**	**-14 526,3**	**0,0**	**0,0**	**0,00**

(1). In order to avoid distortions due to fluctuations in the size of the UK rebate , the projected amount of the UK correction for 1999, instead of the one of 1998, has been chosen for comparison purposes (in principle the financing is lagged one year);

(2) the UK correction for 1999 is estimated at *Euro 4 952 million;* the difference between this amount and Column (4) is due to the procedure foreseen in Article 4, paragraph 2 d) of the Own Resources Decision which takes into account the so-called "*advantage*" that the UK enjoys due to the changeover to a capped VAT own resource and the introduction of the GNP-based own resource.

The results reported in Tables 1 and 2 refer to 1999[9], the last year of the current Financial Perspective. The final results are presented in terms of the difference relative to the present system; that is, the results show the improvement (deterioration) of the budgetary balance of each Member State relative to the current regime.

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8 The budgetary balance à la UK correction is a cash concept defined by the difference between the share in financing and the share in allocated operational expenditure; traditional own resources (TOR) are reallocated among Member States according to their VAT and GNP shares, while the sum of all balances is restricted to be zero. See Annex 3 for a discussion of the definitions of the budgetary balance used in this report.

9 Data based on the Preliminary Draft Budget of the European Union for the financial year 1999, COM (98) 300. The concept of EU expenditure used in the simulations is allocated expenditure including administrative expenditure; if the estimates were prepared on the basis of operating expenditure, excluding administrative expenditure, the order of magnitude by which the rebates and their financing would be modified is somewhat less than 5 per cent.

Table 2

Implications for budgetary balances by applying an unconstrained generalised correction mechanism

(data for 1999 in Euro million and in percent of GNP)

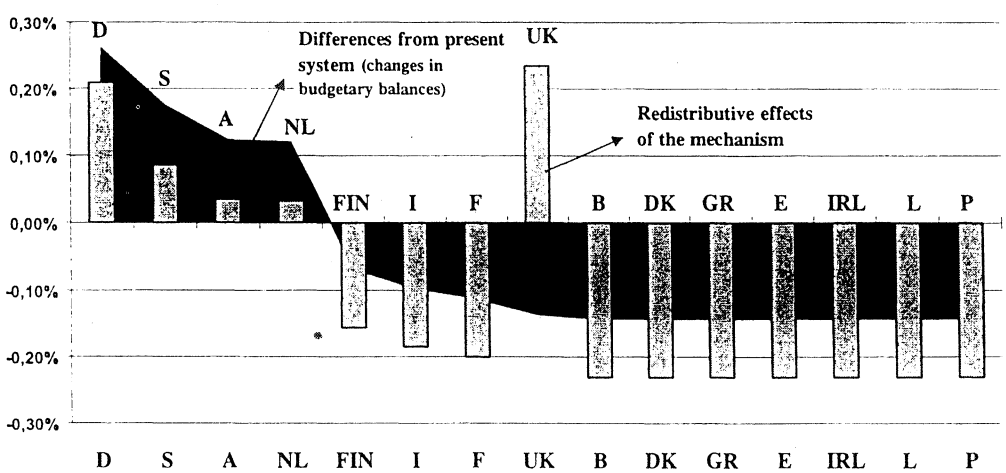
	Budgetary balance à la UK correction				*"Operational" budgetary balance*			
	Redistributive effects of the mechanism		*Difference to the current system*		*Redistributive effects of the mechanism*		*Difference to the current system*	
	Euro mio.	% of GNP	Euro mio.	% of GNP	Euro mio.	% of GNP	Euro mio.	% of GNP
B	- 538.9	- 0.23	- 333.7	- 0.14	237	0.10	400	0.17
DK	- 357.7	- 0.23	- 221.5	- 0.14	-440	-0.29	-332	-0.22
D	***4 110.1***	***0.21***	***5 117.9***	***0.26***	***3 980***	***0.20***	***4 780***	***0.24***
GR	- 256.4	- 0.23	- 158.8	- 0.14	-318	-0.29	-241	-0.22
E	- 1 197.8	- 0.23	- 741.8	- 0.14	-1 502	-0.29	-1 139	-0.22
F	- 2 649.1	- 0.20	- 1 483.9	- 0.11	-3 235	-0.24	-2 310	-0.17
IRL	- 145.7	- 0.23	- 90.2	- 0.14	-184	-0.29	-140	-0.22
I	- 2 014.5	- 0.19	- 1 057.8	- 0.10	-2 510	-0.23	-1 750	-0.16
L	- 38.3	- 0.23	- 23.7	- 0.14	38	0.23	49	0.30
NL	***111.8***	***0.03***	***422.5***	***0.12***	***760***	***0.22***	***1 007***	***0.29***
A	***67.9***	***0.03***	***240.6***	***0.12***	***-6***	***0.00***	***131***	***0.07***
P	- 226.7	- 0.23	- 140.4	- 0.14	-281	-0.29	-212	-0.22
FIN	- 176.0	- 0.16	- 77.2	- 0.07	-230	-0.20	-151	-0.13
S	***184.6***	***0.09***	***373.1***	***0.17***	***174***	***0.08***	***324***	***0.15***
UK	3 126.9	0.23	- 1 825.2	- 0.13	3 517	0.27	-414	-0.03

The parameters of the correction mechanism are: Threshold = 0.0% of GNP; coefficient of compensation = 0.66; the definition of the budgetary balance as "à la UK correction" and as "operational" is provided in Annex 3.

Graph 1

Implications of an unconstrained generalized correction mechanism

("UK rebate" balance) **Projections for 1999 in percent of GNP**



The budgetary balance of the Member States for 1999 (calculated "à la UK correction") appears in column 1, the gross amounts of the rebates to the eligible Member States appear in column 4, the financing of the rebates in column 5, and the amount net of financing in column 6. Columns 7 and 8 give in absolute value and in percentage terms the new budgetary balances. The changes in the budgetary balance of each Member State in 1999, both in Euro and in percent of GNP, are presented in Table 2 where also data with respect to the current regime are shown. The last two columns in Table 2, which cannot be reconstructed from the data in Table 1, give the difference with respect to the present system (which includes the UK correction). In particular, the difference relative to the present system, for each Member State, is equal to the new budgetary balance resulting from the application of the proposed mechanism (column (7) of Table 1) minus the sum of the budgetary balance reported in column (1) of Table 1 (which is reported before the UK correction) and the financing of the UK correction.

Whereas the application of the present correction mechanism would redistribute in 1999 Euro 4.9 billion towards the United Kingdom alone, the unconstrained correction mechanism would redistribute Euro 7.6 billion towards five countries (Germany, the Netherlands, Austria, Sweden and the United Kingdom). This amount would have to be financed by the other 10 Member States that would pay Euro 4.3 billion more than under the present correction mechanism (Euro 3.3 billion). The United Kingdom would be worse off by Euro 1.8 billion. The new beneficiaries of the system (Germany, the Netherlands, Austria, and Sweden) would therefore see an improvement in their aggregate budgetary balance by Euro 6.1 billion (5.1 billion for Germany alone).

Graph 1 helps to visualise the redistribution induced by this unconstrained generalised mechanism. The shaded area corresponds to the difference between the unconstrained mechanism and the present system and includes all financing effects for the UK rebate; the bars refer only to the redistribution (corresponding to column (6) of Table 1) induced by the new unconstrained system. The Member States are ranked from the one with the greatest improvement in the budgetary balance to that with the greatest deterioration.

Those Member States that are currently recording a positive budgetary balance (Belgium, Denmark, Greece, Spain, Ireland, Luxembourg and Portugal) would not receive any rebate but would only participate in the financing of the mechanism. They will all witness an equal deterioration in their budgetary balance in terms of national GNP.

Those Member States who are net payers would, on the contrary, receive a rebate for their budgetary imbalance. In some cases this rebate would more than compensate the financing of others' rebate, in other cases not. This obviously depends on the size of the initial budgetary imbalance.

The case of the United Kingdom is somewhat more complex. The UK would be entitled to the same rebate as under the current rebate mechanism but it would also have to contribute its share in the financing of the unconstrained generalised mechanism.

Thus, relative to the present system, the UK finds its budgetary balance deteriorating due to the financing of the others' rebate; in the new system, as shown by the bars, the UK would be as big a beneficiary as Germany (as a percentage of GNP).

4. A CONSTRAINED GENERALIZED CORRECTION MECHANISM

As discussed in section 2, a constrained generalised correction mechanism has been explicitly proposed by Germany, Austria, Sweden and the Netherlands. This section examines the implications of this proposal. The constraint in the mechanism is given by the threshold; budgetary imbalances exceeding the threshold ought to be corrected. In the proposal, a threshold of 0.30 per cent or 0.40 per cent of GNP has been suggested.

Table 3

Implications for budgetary balances of a constrained generalised correction mechanism*

Projections for the year 1999; "UK rebate" balance [1] (data in Euro million and in % of GNP)

	Budgetary balance "à la UK correction" (before UK correction)		MS eligible for a rebate	Amount of compensation	Financing	Total redistributive effect (4) + (5)	New budgetary balance	
	Euro million	% of GNP	Threshold 0,3 % of GNP	Coefficient 0,66	GNP share	Gains/losses from the mechanism	Euro million (1) + (6)	% of GNP
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
B	2 131,7	0,92	0,0	0,0	- 210,8	- 210,8	1 920,9	0,82
DK	188,8	0,12	0,0	0,0	- 139,9	- 139,9	48,9	0,03
D	***-9 804,8***	***-0,50***	***-3 903,8***	***2 576,5***	***- 907,9***	***1 668,6***	***-8 136,2***	***-0,41***
GR	5 221,0	4,71	0,0	0,0	- 100,3	- 100,3	5 120,7	4,62
E	8 006,8	1,55	0,0	0,0	- 468,5	- 468,5	7 538,3	1,46
F	- 516,8	-0,04	0,0	0,0	-1 196,7	-1 196,7	-1 713,5	-0,13
IRL	2 570,4	4,08	0,0	0,0	- 57,0	- 57,0	2 513,4	3,99
I	- 649,5	-0,06	0,0	0,0	- 982,7	- 982,7	-1 632,1	-0,15
L	717,8	4,33	0,0	0,0	- 15,0	- 15,0	702,9	4,24
NL	***-1 342,0***	***-0,38***	***- 284,2***	***187,6***	***- 310,2***	***- 122,6***	***-1 464,7***	***-0,42***
A	***- 770,2***	***-0,39***	***- 182,2***	***120,2***	***- 174,3***	***- 54,0***	***- 824,3***	***-0,42***
P	3 173,1	3,24	0,0	0,0	- 88,7	- 88,7	3 084,5	3,15
FIN	- 124,9	-0,11	0,0	0,0	- 101,5	- 101,5	- 226,4	-0,20
S	***-1 001,6***	***-0,47***	***- 359,6***	***237.4***	***- 187,0***	***50,4***	***- 951,2***	***-0,44***
UK	-7 799,8	-0,58	-3 798,3	2 506,9	- 688,2	1 818,7	-5 981,1	-0,45
TOTAL	**0,0**	**0,00**	**-8 528,1**	**5 628,5**	**-5 628,5**	**0,0**	**0,0**	**0,00**

(1) See footnote (1) of Table 1.

Table 3 shows the results of a simulation for the year 1999 of the constrained correction mechanism. The net burden is calculated as in the UK rebate, and a threshold of 0.30 per cent of GNP and a coefficient of compensation of 0.66 have been assumed. The principal effects of the mechanism, both in terms of the redistributive impact and in terms of differences with respect to the current regime, are summarised in Table 4.

Table 4

Implications for budgetary balances by applying a constrained generalised correction mechanism

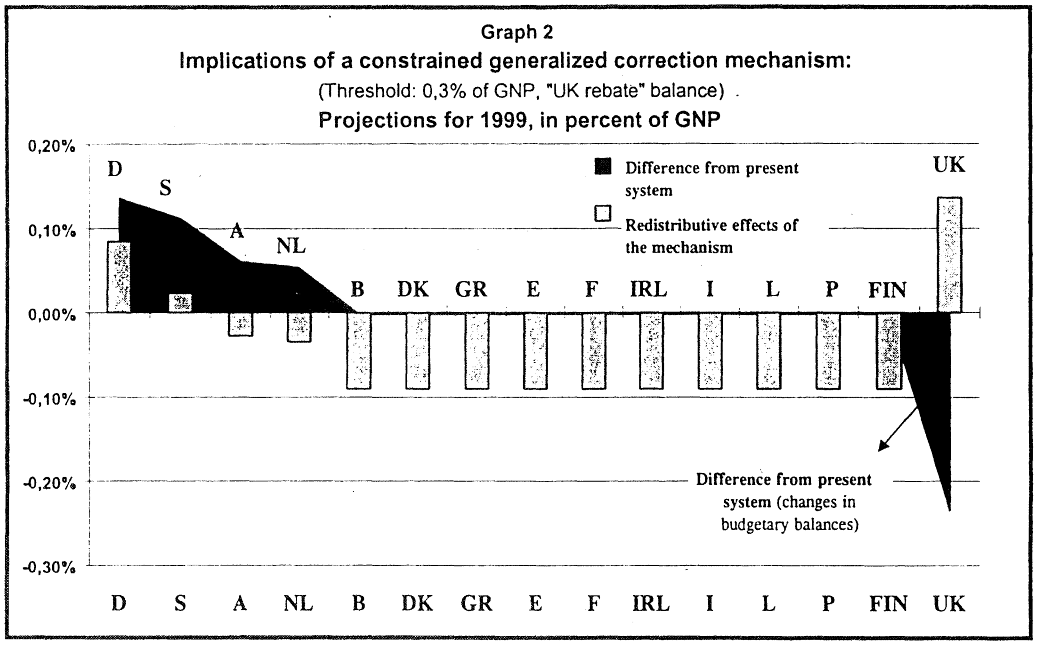
(data for 1999 in Euro million and in percent of GNP)

	Budgetary balance à la UK correction				*"Operational" budgetary balance*			
	Redistributive effects of the mechanism		*Difference to the current system*		*Redistributive effects of the mechanism*		*Difference to the current system*	
	Euro mio.	% of GNP	Euro mio.	% of GNP	Euro mio.	% of GNP	Euro mio.	% of GNP
B	- 210.8	- 0.091	- 5.6	- 0.002	114	0.05	277	0.12
DK	- 139.9	- 0.091	- 3.7	- 0.002	-209	-0.14	-101	-0.07
D	***1 668.6***	***0.085***	***2 676.4***	***0.136***	***1 727***	***0.09***	***2 527***	***0.13***
GR	- 100.3	- 0.091	- 2.6	- 0.002	-151	-0.14	-74	-0.07
E	- 468.5	- 0.091	- 12.4	- 0.002	-714	-0.14	-352	-0.07
F	- 1 196.7	- 0.091	- 31.6	- 0.002	-1 827	-0.14	-902	-0.07
IRL	- 57.0	- 0.091	- 1.5	- 0.002	-88	-0.14	-43	-0.07
I	- 982.7	- 0.091	- 25.9	- 0.002	-1 504	-0.14	-744	-0.07
L	- 15.0	- 0.091	- 0.4	- 0.002	30	0.18	42	0.25
NL	***- 122.6***	***- 0.035***	***188.0***	***0.053***	***563***	***0.16***	***809***	***0.23***
A	***- 54.0***	***- 0.028***	***118.7***	***0.061***	***-108***	***-0.05***	***29***	***0.01***
P	- 88.7	- 0.091	- 2.3	- 0.002	-134	-0.14	-65	-0.07
FIN	- 101.5	- 0.091	- 2.7	- 0.002	-156	-0.14	-77	-0.07
S	***50.4***	***0.024***	***239.0***	***0.112***	***63***	***0.03***	***213***	***0.10***
UK	1 818.7	0.136	- 3 133.4	- 0.235	2 393	0.18	-1 538	-0.12

The parameters of the correction mechanism are: Threshold = 0.30% of GNP; coefficient of compensation = 0.66; the definition of the budgetary balance as "à la UK correction" and as "operational" is provided in Annex 3.

The results show that the constrained version of the correction mechanism entails a significantly lower redistribution of budgetary resources. Only three countries would benefit from the system (Germany, Sweden and the United Kingdom) since in the case of the Netherlands and Austria, the benefit from the capping of their budgetary balances would be smaller than their contributions to the financing of the system. On the whole, the 12 Member States financing the rebates would be paying Euro 3.5 billion which is 0.2 billion less than what they would have paid to finance the current UK rebate mechanism. The United Kingdom, on the other hand, would be worse off by Euro 3.1 billion. This amount would be divided between the 12 Member States already mentioned (Euro 0.2 billion), Sweden, (Euro 0.2 billion) and Germany (Euro 2.7 billion).

The results of Table 4 are also shown in Graph 2. Here, the shaded area shows the differences in the Member States' budgetary balances between the present system, which includes the UK correction, and the system of the constrained generalised mechanism. In the Graph, the Member States are again ranked from the one with the greatest improvement in the budgetary balance to that with the greatest deterioration. The changes in the budgetary balances are identical for all the financing Member States that are not eligible for the rebate. Their budgetary balance is projected to deteriorate by some 0.002 per cent of GNP in 1999.



The UK, on the contrary, will find itself substantially worse off. Under the unconstrained version of the mechanism the UK rebate was determined in a manner identical to the current system and, therefore, the UK saw a deterioration only because of its participation in the financing of the rebate of the others. In the present, constrained, simulation the UK rebate is restricted to the excess of its negative budgetary balance above the 0.30 per cent of GNP threshold. As a consequence, the budgetary imbalance of the UK, as measured by the "UK rebate" budgetary balance, would worsen by some 0.24 per cent of GNP in 1999.

5. A GRAPHICAL REPRESENTATION OF THE RESULTS

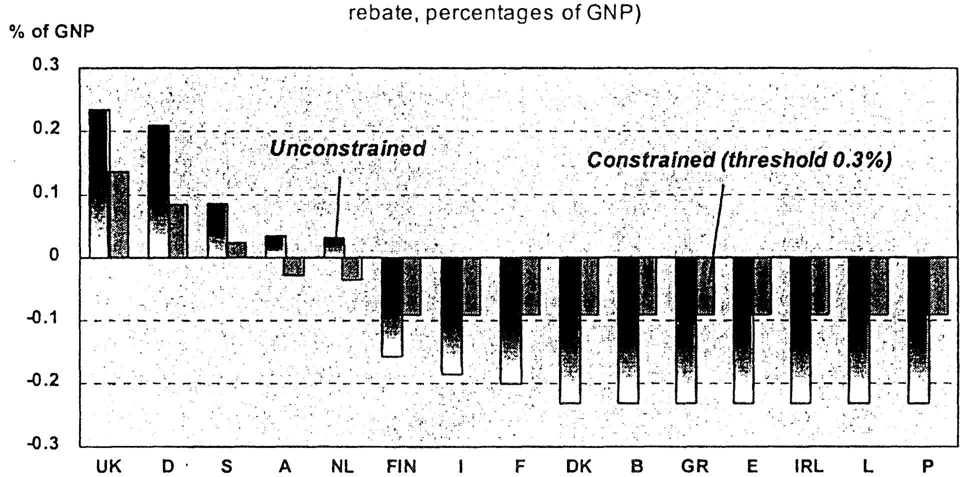
Budgetary correction mechanisms similar to the current one in favour of the United Kingdom are imperfect and, since they operate on the revenue side of the budget, do not affect the fundamental source of imbalances, the expenditure side. Moreover, beyond the conceptual and practical difficulties involved, they require an agreed definition of budgetary imbalance. Notwithstanding these imperfections, an explicit proposal has been made by Germany, the Netherlands, Austria and Sweden to address concerns about excessive budgetary imbalances.

The analysis in this Annex reviewed two versions of a correction mechanism: an unconstrained correction mechanism and a constrained one. It is clear that, given the complexity and lack of transparency of the present system involving only the UK rebate, extending it to other Member States would inhibit further the comprehension and clarity of EU budgetary relationships.

Graph 3

Redistributive effects of the two correction mechanisms under review

(Projections for 1999, budgetary balances defined as in the UK rebate, percentages of GNP)

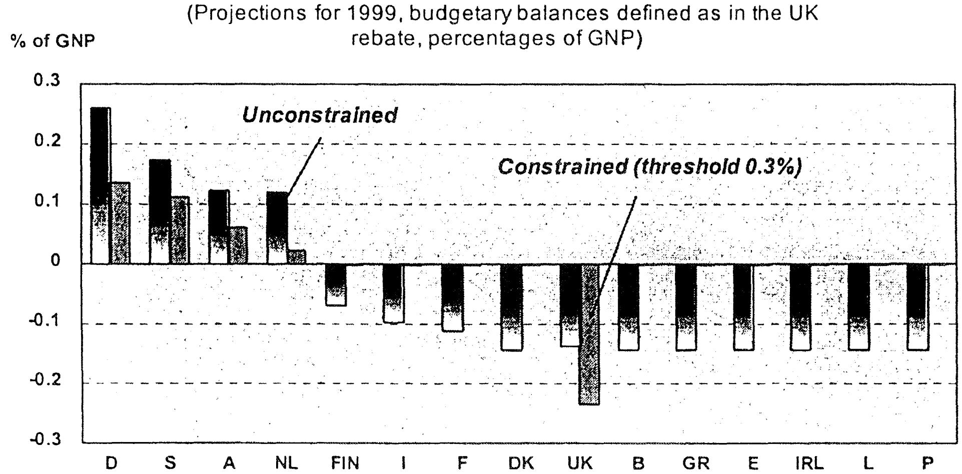


Applying the present mechanism to all Member States that record a negative budgetary balance, or simply extending to the four countries that have made the request, would increase the sum of all rebates by about 50 per cent compared to the present system involving only the UK rebate. A constrained mechanism would involve a lesser amount of resources to be.

Graph 4

Changes in budgetary balances with respect to the current regime due to the two correction mechanisms under review

(Projections for 1999, budgetary balances defined as in the UK rebate, percentages of GNP)



The results of the various simulations are summarised in Graphs 3 and 4. Graph 3 shows the redistributive effect of the introduction of the generalised correction mechanisms (this corresponds to the bars of Graphs 1 and 2) and Graph 4 compares the changes that either of the two correction systems would entail with respect to the current situation (this corresponds to the shaded area of Graphs 1 and 2). The imposition of constraints limits the resources to be redistributed as well as the number of Member States benefiting from these dwindling resources.

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Progressivity in budget contributions

1. INTRODUCTION

On July 1, 1998 Mr Rodrigo Rato, Spain's Economics Minister and second Deputy Prime Minister, and Mr Abel Matutes, Foreign Minister wrote a joint letter to the Commission President proposing the introduction of a new own resource based on progressivity and requesting the Commission to examine this proposal in the framework of the Own Resources Report. The Spanish delegation reiterated the proposal during the EcoFin meeting of July 6, while Portugal and Greece voiced their support. Some days later, the Portuguese and the Greek authorities also wrote to President Santer to express their support for the Spanish proposal.

As in the case of the suggestion of the four Finance Ministers (of Germany, the Netherlands, Austria and Sweden) who have asked for an extension of the Fontainebleau rebate to their countries, the Spanish authorities do not propose one specific course of action, but indicate a number of ways - all based on the GNP resource - in which the objective of progressivity in contributions could be achieved.

The Spanish authorities base their initiative on the text of the Protocol on Economic and Social Cohesion where the high contracting parties *"declare their intention of taking greater account of the contributive capacity of individual Member States in the system of own resources, and of examining means of correcting, for the less prosperous Member States, regressive elements existing in the present own resources system"*.

Ministers Matutes and Rato acknowledge that the introduction of the GNP resource represents a marked improvement with respect to the previous situation. However, they regret that proportionality of contributions to income, characterizing the present system, does not take into account sufficiently the contributive capacity of Member States. The Ministers state clearly that a fair system of contributions ought to be based on progressivity as are the fiscal systems of all the Member States. They believe that the phase of integration reached by the European Union with the signature of the Amsterdam Treaty clearly warrants a move towards a financing system based on *"equity and progressivity"*.

The present Annex, which together with the introduction, includes five sections, reviews the proposal and its implications. Section 2 presents the proposal; section 3 provides a brief review of the history of the concept of progressivity; section 4 examines progressivity in relation to economic and social cohesion; and section 5 provides some final remarks.

2. THE PROPOSAL CONCERNING PROGRESSIVITY AND SOME IMPLICATIONS

Spain proposes to achieve progressivity by applying "modulation coefficients" (to reflect "relative wealth" and "relative prosperity", two terms used interchangeably) to the actual GNP bases so as to derive new GNP bases to be used in the calculation of the GNP resource contributions. No clear mention is made of which "modulation coefficients" are to be used, but it is said that the measure of "relative wealth" should be GNP per capita in ECU.

The proposal involves a fundamental adjustment to be applied in either of two ways in order to achieve progressivity.

A) To use as coefficient for the construction of the new GNP bases an index of GNP per capita in ECU (with EU= 100, in 1996 this was 124.9% for Germany, 64.5% for Spain, 85.8% for the U.K. and 114.2% for France etc.).

B) To apply the correction coefficients only to a part of the GNP bases (e.g. 50 per cent) leaving the remaining unaffected. In this case, the GNP resource would be disaggregated into a proportional and into a progressive component, each with its own uniform contributions rate.

C) To group countries on the basis of GNP per capita and to apply the same coefficients for all the countries in the same group; no indication is given of what these coefficients should be and how they should be calculated.

Finally, it is suggested that the current VAT resource could be replaced by this modified GNP resource. The proposal amounts to substituting the actual GNP keys with keys more favourable to poorer Member States, and to apply the new keys either to less than 40% of contributions to the EU budget[1] (version B), or to about 40% of them (version B and possibly C), or even to more than 80 per cent of the total, if the VAT resource were to be suppressed.

It is clear that, in terms of redistributing the burden of the financing of the EU budget, the proposal would make those countries whose GNP per capita in ECU is higher (lower) than the average pay more (less) than under the current rule. This is because the proposal amplifies (reduces) the GNP base of the Member States with a GNP higher (lower) than the average.

Under either option Belgium, Denmark, Germany, France, Luxembourg, the Netherlands, Austria and Sweden, would be expected to contribute significantly more than under the present system. Table 1 presents results (in Ecu million and in percent of total contributions) of the application to the data of 1996 and 1997 of the idea of modifying the GNP bases according the ECU index of GNP per head (option A). According to the results, in 1997 Belgium would have paid Ecu 70 million more,

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1 Which is the current importance of the GNP resource in the EU budget.

Denmark Ecu 180 million, Germany Ecu 1043 million, France Ecu 260 million, Luxembourg Ecu 48 million, the Netherlands Ecu 45 million, Austria Ecu 102 million, and Sweden Ecu 70 million. Greece would have seen its contributions fall by Ecu 204 million, Spain by Ecu 803 million, Ireland by Ecu 45 million, Italy by Ecu 465 million, Portugal by Ecu 200 million and the UK by Ecu 100 million. Finland's contributions would have been largely unchanged.

Table 1

Modifications of the national contributions relative to the present system
Proposal applied to the total of the GNP resource
(adaptation of the GNP bases using the ECU index of GNP per head, in Ecu million and in per cent of total contributions)

	1996		1997	
	Ecu million	%	Ecu million	%
B	75.9	2.7	70.0	2.3
DK	134.9	9.6	178.6	11.6
D	1105.6	5.2	1043.4	4.8
GR	-155.4	-13.8	-204.1	-17.1
E	-551.1	-11.9	-803.9	-14.8
F	311.0	2.5	259.1	1.9
IRL	-45.4	-6.5	-45.4	-6.4
I	-404.0	-4.4	-466.4	-5.3
L	38.2	23.5	47.9	27.7
NL	55.3	1.2	44.5	0.9
A	102.3	5.4	102.0	4.8
P	-152.2	-17.6	-199.3	-18.2
FIN	-6.7	-0.7	1.3	0.1
S	67.9	3.4	71.1	3.0
UK	-576.2	-6.8	-98.9	-1.1
Total	**0.0**		**0.0**	

1) The technicalities of the proposal result in these countries marginally benefiting from the operation of the progressivity mechanism even if their index of GNP per head is slightly above 100 (see section 4 of this Annex)

Option B would clearly give the same results as option A but scaled in proportion to the part of the GNP base to which the "modulation coefficients" are to apply.

Table 2 presents results of the application of the same adjustment to the GNP base after suppressing the VAT resource. In this case, the suppression of the VAT resource and its replacement by the progressive GNP resource results in larger differences compared to both the previous simulation and, clearly, to the present system. Finally, it is not possible to simulate the third option since it would be necessary to determine the "modulation coefficients" for each group of Member States. Nevertheless, it should be clear that with plausible values the simulation would give quantitative results not differing substantially from those shown in Tables 1 and 2.

The implications of the proposal for contributions are consistent with what could be predicted a priori. However, the fact that under progressivity there will be a significant redistribution of the burden of financing EU expenditure, from the more wealthy in favour to the less wealthy Member States, cannot constitute a criticism of the proposal since, indeed, this redistribution is its fundamental purpose. The proposal, with its prima facie appeal, ought to be examined principally in terms of its consistency in relation to the predictions of economic theory as well as against its consistency with the practice of implementing progressivity in the EU through expenditure policies.

Table 2

Modifications of the national contributions relative to the present system
Proposal applied to the GNP resource, VAT resource suppressed
(adaptation of the GNP bases using the ECU index of GNP per head, in Ecu million and in per cent of total contributions)

	1996		1997	
	Ecu million	%	Ecu million	%
B	310.4	10.9	303.0	9.8
DK	450.5	32.2	493.7	32.1
D	2 034.4	9.6	1 396.0	6.5
GR	-445.2	-39.7	-471.3	-39.4
E	-1 396.9	-30.2	-1 758.9	-32.4
F	821.9	6.53	504.3	3.8
IRL	-137.3	-19.5	-117.6	-16.5
I	-234.5	--2.57	11.8	0.1
L	89.4	55.0	98.6	56.9
NL	128.6	2.8	115.3	2.3
A	263.8	13.9	184.9	8.6
P	-432.9	-49.9	-475.5	-43.4
FIN	35.3	3.6	39.5	3.7
S	323.7	16.1	259.8	11
UK	-1 811.2	-21.3	-583.8	-6.3
Total	**0.0**		**0.0**	

These considerations are examined in the next two sections. Section 3 reviews the argument for the adoption of progressivity for personal taxation, while section 4 reviews the argument for the transposition of the concept of progressivity from personal taxation to the Member States' contributions to the EU budget; and the closing section 5 presents some final remarks.

3. A BRIEF REVIEW OF THE CONCEPT OF PROGRESSIVITY IN PERSONAL TAXATION

The concept of progressivity is well known in the optimal taxation literature. It is closely linked with the concept of equity. The debate on equity in taxation has revolved around two doctrines, the benefit doctrine (taxes should be paid according to one's interests in the public estate) and the ability to pay doctrine (one should pay according to her/his means)[2]. One of the desirable characteristics of the tax system, argued by Adam Smith, is that some progressivity is desirable (especially for income from capital). However, this was not subscribed to unanimously by benefit theorists.

The ability to pay doctrine can be said to originate with John Stuart Mill[3] and his concept of "equality of sacrifice". Mill, concerned about the disincentive effect of progressive taxation, argued for a proportional taxation of income. Having stated the equity issue in terms of equal sacrifice, Mill initiated the debate concerning *equal absolute* and *equal marginal* sacrifice, the former calling for proportional and the latter for progressive taxation.

Both the benefit doctrine and the ability to pay doctrine need an index to define inequality among individuals. Since Adam Smith, the emphasis has traditionally been on the income and wealth base (with higher taxation concentrated on the latter), but a comprehensive and global income tax, as the current used in most Member States[4], emerged only in this century. However, a consumption base for taxation was also in the mind of several theorists beginning with Adam Smith.

Mirrlees' (1971) seminal contribution extended further the analysis of these issues[5]. Here, to ensure that vertical equity is respected, a constraint is imposed so that the order of the gross income cannot be different from the order of the net income. The government is choosing the tax schedule that maximises social welfare subject to an exogenous state revenue requirement and the constraint. Mirrlees concluded that,

- *First*, "an approximately linear income-tax schedule, with all the administrative advantages it would bring, is desirable"[6]. This corresponds to *proportional taxation* across individuals. This is not contrary to the desirability of progressivity. Progressivity should be related to the average tax, and it is attained as long as the

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2 Curiously enough, Adam Smith, the father of the *laissez-faire* doctrine, deserves credit for linking taxation to ability to pay (or, in our context, contributive capacity) but tempering it by a benefit principle. The importance he attached to proportionality is also worth noting. His first "maxim" (*The Wealth of Nations,* G. P. Putnam's Sons, New York, 1904, Vol. II, p. 310) reads: "The subject of every State ought to contribute towards the support of the government, as nearly as possible in *proportion to their respective abilities*; that is *in proportion to the revenue* which they respectively enjoy under the protection of the state. The expense of the Government to the individuals of a great nation, is like the expense of management to the joint tenants of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate. In the observation or neglect of this maxim consists what is called equality or inequality of taxation" *(italics added)*. Whether this is more supportive of the benefit principle or of the ability to pay principle is not easy to answer.

3 See John Stuart Mill, *Principles of Political Economy*, Collier and Son, New York, 1900.

4 Scandinavian countries that have adopted the so-called Dual Income Tax are a notable exception. The Dual Income Tax levies more taxes on labour income than capital income on simple efficiency grounds (labour is less mobile than capital). For a discussion of the Dual Income Tax see S. Cnossen (1998): "Taxing Capital Income in the European Union, the Case for Adopting the Dual Income Tax", mimeo presented at a conference on "Tax Competition and Co-ordination of Tax Policy in the European Union" organised by the Austrian Federal Ministry of Finance in co-operation with the Austrian Institute of Economic Research, Vienna, July 13-14.

5 See J. A. Mirrlees (1971): "An Exploration in the Theory of Optimum Income Taxation", *Review of Economic Studies*, vol. 38, p. 175-208.

6 Mirrlees (1971): op. cit., p. 208.

marginal tax rate exceeds the average one. It is, however, clear that there are few arguments in favour of a strong progressivity of the tax system in terms of a steeply increasing marginal tax rate[7,8].

- *Second*, "the income tax is a much less effective tool for reducing inequalities than has often been thought"[9].
- *Third*, marginal tax rates are quite low, which implies a reduced use of progressivity[10].

The idea that relative (among individuals) prosperity must be an element in the determination of the tax burden is, therefore, confirmed and while progressivity is accepted, its "optimal" magnitude is lower than initially thought.

The evolution of most European tax systems since the beginning of the 1970s appears to suggest that most of Mirrlees' points have been very well understood and widely adopted in public policy. Marginal rates on personal taxation have been reduced dramatically across Europe accompanied by a widening of the tax base. Income redistribution has been pursued via targeted expenditure policy. A lesson generally well understood is that the more inelastic the labour supply is, the higher labour can be taxed, but when the labour supply is elastic the disincentives contained in the progressive income tax are powerful. Later studies in this area have further confirmed the robustness of Mirrlees' conclusions.

4. PROGRESSIVITY OF MEMBER STATES CONTRIBUTIONS AND ECONOMIC AND SOCIAL COHESION

When taxpayers are Member States instead of single individuals the issues at hand are different. A transposition of the optimal taxation rule from the area of personal taxation to a national level is not possible, essentially because it involves the problem of aggregation across individuals. Moreover, it is not even clear that it is meaningful to apply principles of personal taxation to national states as a whole.

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7 Mirrlees (1971): op.cit. obtained three technical results. 1) The marginal tax rate is always between zero and one; 2) at the top income the marginal tax rate is zero; 3) At the bottom, if the lowest paid is working, the marginal tax rate is zero. For a thorough discussion of the optimal non-linear income taxation see N. Stern (1984): "Optimum Taxation and Tax Policy", *IMF Staff Papers*, Vol. 31, no.2, June.

8 M. Tuomala ("On the Optimal Income Taxation, Some Further Numerical Results" *Journal of Public Economics 23*, 1984) proved that zero taxation at the "top" applies to an extremely limited subset of individuals (much less than the last centile). Other interesting numerical results are also reported in M. Tuomala (1990): *Optimal Income Tax and Redistribution*, Clarendon Press, Oxford.

9 Mirrlees (1971): op. cit., p. 208.

10 Mirrlees himself was surprised by this result. "I must confess that I had expected the rigorous analysis of income taxation in the utilitarian manner to provide arguments for high tax rates. It has not done so"; Mirrlees (1971): op. cit., p. 207

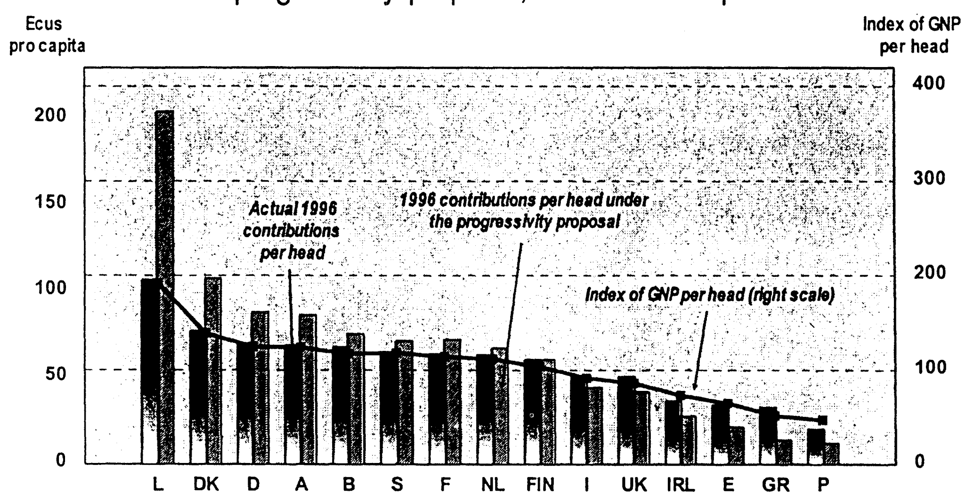
In the EU, steps towards reducing the regressive elements of the own resources system, in accordance with the Protocol on Economic and Social Cohesion, have already been put in place.

This Protocol reads "The high contracting parties...NOTING the proposal to take greater account of the *relative prosperity* of Member States in the system of own resources...DECLARE their intention to take greater account of the *contributive capacity* of individual Member States in the system of own resources, and of examining means of *correcting, for the less prosperous Member States regressive elements* existing in the present own resource system" (*italics added*, capital letters in the original).

The High Contracting Parties have, therefore, established through this protocol that the proper way to take greater account of the Member States' *relative prosperity in the system of own resources* is by considering their *contributive capacity* and by *eliminating any regressive elements for the less prosperous Member States*.

Graph 1

Actual GNP own resources payments in 1996, GNP payments under the progressivity proposal, index of GNP per head



The Own Resource Decision of 31 October 1994, which transposes into law the declaration of Protocol 15, has indeed taken greater account of Member States' contributive capacity by reducing progressively the VAT maximum rate (thus increasing the weight of the GNP resource) and has corrected the regressive elements for the less prosperous Member States by immediately reducing the maximum VAT share to 50% of GNP for the Cohesion Member States. Both measures are aimed at making Member States' contributions proportional to their GNP.

Proportionality of contributions to Member States' GNP ensures at the same time proportionality with GNP contributions per head, as Graph 1 shows. Substituting for the proportional GNP resource a progressive one means tilting payments around the average, imposing higher charges on those above and lower charges on those below the average. This raises several problems of technical and conceptual nature.

- Progressivity is generally achieved by differentiating the tax rates which taxpayers face, but not by enlarging or restricting the base on which taxes are levied. This is due to the need to avoid offending the principle of horizontal equity and to respect the principle of *base invariance* which guaranties respect of vertical equity. On the contrary, the Spanish proposal to use Ecu GNP per capita as the coefficient of progressivity to be applied to the GNP shares, amounts to achieving progressivity by enlarging or restricting ones' base[11] and leaving the rate (GNP call rate), at least in one variants of the proposal, equal for all. ***Affecting the GNP bases amounts to artificially widening the differences in total income among the Member States.*** Two Member States with the same "true" GNP base will appear to have different "fictitious" bases. ***Clearly, determining contributions by the adjusted bases would offend horizontal equity.***

- The resulting adjustment in the base is not without other, more significant, consequences. Since the weights used in the construction of the new GNP bases are GNP per head, ***the weighted sum of the GNP base on which the GNP resource is levied will not be equal, except by coincidence, to the unweighted sum of the original GNP base.*** Furthermore, it is inevitable that the adjusted GNP base will be greater than the original one since the richer Member States are invariably the larger ones too. For example, in 1997 the original GNP base is estimated at Ecu 70 202 million; the weighted GNP base becomes Ecu 73 418 million. As a result of this, and given the fixed amount to be financed through the GNP resource, ***the GNP call rate is lower than the original one*** – in 1997 the original one was 0.403 and the one obtained from the adjusted base is 0.385. The implicit reduction in the GNP call rate implies that those Member States with an index of GNP per capita less than 100 (the EU average) will see their contributions on the GNP resource reduced by the influence of two effects, first, the reduction in the base as a result of the adjustment and, second, a reduction due to the fall in the call rate. The richer Member States with per capita GNP higher than 100, on the other hand, will see their increased contributions somewhat compensated by the reduction in the GNP call rate. One of the clear difficulties of the proposal is those Member States around the EU average may see their GNP contributions fall, compared to the present regime, if the increase in the GNP base is more than compensated by a reduction in the GNP call rate. This occurs in the case of Finland and the UK in the years reported in Table 1 and in Table 2 below.

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11 It would be as if the taxable base of the affluent (poor) taxpayers would be multiplied by a coefficient higher than 1 because of their affluence (poverty) and this would widen the differences between taxpayers beyond reality. To the best of our knowledge, there are no significant examples of this type of procedure for income taxation in any fiscal code.

- Substituting proportionality with respect to the GNP resource with progressivity may not necessarily foster real convergence and economic and social cohesion.

    - Whether progressivity in budgetary contributions is an efficient way to achieve economic convergence is an open question. Solidarity and convergence policies in the EU take the form of a common effort to improve the structural endowment of the less prosperous regions, not of money redistribution. These EU policies direct aid to less wealthy Member States in areas where development needs and convergence gaps are greatest. The EU contributes significantly through its Structural Funds and through many of its other policies to improving the level of infrastructure, education, and scientific research in the less prosperous regions and Member States. This differs significantly in both political and economic terms from forms of financial redistribution like, for instance, the "Finanzausgleich" mechanism existing in the Federal Republic of Germany, which require as political background a much greater sense of solidarity and common purpose than currently present in European integration.

    - If solidarity were to take the form of redistributing moneys, and assuming that present consumption and future consumption (investment) are normal goods[12], it is certain that aid would be partly used to finance current consumption. By implementing redistribution on the expenditure side, this potential "waste" is minimised. Policy financing rather than money redistribution is presumed to be a superior way to ensure that solidarity and real convergence are pursued both consistently and efficiently and that money is channelled towards investment, rather than consumption, thus increasing the recipients' growth rate and reducing development gaps.

    - Progressivity could foster convergence, ceteris paribus, if the funds made available were to supplement existing, expenditure based, convergence expenditure. However, it is possible that those Member States, who have prominently displayed what might be called "contributions fatigue" (Germany, the Netherlands, Austria and Sweden) may not accept a further deterioration of their budgetary position, but instead they demand a corresponding decrease of expenditure policy to offset the money made available to benefiting Member States through progressivity in contributions. Under these circumstances, the convergence process could undoubtedly be retarded since a part of the newly available funds will be spent on current consumption.

- The present system of expenditure-based progressivity may be thought of as ***a rules-based system*** in which convergence expenditure is "tied" to specific projects and to explicit financial and other procedures and parameters. A system of

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12 Normal goods are those whose consumption increases as income increases. This means that for a given Δx increase in income a proportion $\alpha\Delta x$ is spent in good X and the remaining $(1-\alpha)\Delta x$ is spent for good Y, where $0<\alpha<1$.

progressive contributions would introduce a degree of discretion in convergence policy which structural expenditure has so far not possessed.

A prediction of economic theory is that policy implementation characterised by discretion leads to suboptimal macroeconomic outcomes compared to policy based on rules[13]. Although this prediction was initially restricted to the study of monetary policy, its applicability is more general and can be readily applied to the questions under review. The sub-optimality has much to do with myopic behaviour on the part of those responsible for the policy-making as well as with pressures arising from electoral cycles in democratic societies; with the possibility that under discretionary conditions policy makers may pursue objectives in addition to, or even other than, those consistent with maximising social welfare; and with the possibility that they may even make systematic errors in their assessment of the economic situation and in deciding the appropriate policy. Rules, by contrast, introduce predictability and certainty about the future course of policy and they minimise the interference of political concerns with the optimal policy. Moreover, rules enforce time consistency in policy by ensuring that the optimal policy over a given horizon is not revised half way in favour of a sub-optimal policy.

Pursuing the objective of real convergence, financed through the taxes of European citizens, requires an unwavering commitment to dedicated policies. This commitment cannot be ensured under a regime of discretionary spending for the same reasons that it cannot be guaranteed (indeed, the opposite) in a regime of discretionary monetary or fiscal policy.

- An important component of expenditure-based progressivity as practised in the EU is the ***multilateral surveillance and monitoring function*** performed in a framework where both benefiting Member States and the EU through the Commission agree on the Community Support Framework (CSF) and its implementation. One reason for this framework is to provide a surveillance and monitoring function ensuring, however successfully, that convergence aid is indeed used as intended. This provides a guarantee to the taxpayers of Europe concerning the use of convergence aid. The involvement of recipient Member States is intended to respect subsidiarity in that it acknowledges that recipient Member States are in the best position to propose projects and to judge the appropriateness of convergence expenditure. Under progressivity-related discretionary expenditure, this surveillance and monitoring function would be lost.

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13 The debate about rules versus discretion in economic policy, which has been particularly applied to monetary policy, was initiated by F. Kydland and E. Prescott (1977): "Rules rather than Discretion: The Inconsistency of Optimal Plans", *Journal of Political Economy*, June, p. 473-491; the model was further refined in R. Barro and D. Gordon (1983): "A Positive Theory of Monetary Policy in a Natural-Rate Model", *Journal of Political Economy*, August, p. 589-610. This literature is now large; see finally, as an example, A. Alesina and L. Summers (1993): "Central Bank Independence and Macroeconomic Performance", *Journal of Money, Credit and Banking*, vol. 25, no. 2, May.

- A final issue relates to the character of solidarity in the EU. The objective of solidarity and real convergence has a horizontal dimension and is pursued through transfers to regions, irrespective of whether they are in the more or the less wealthy Member States. By contrast, the proposal under review would establish a vertical dimension in solidarity and convergence assistance, directing it to Member States themselves rather than to regions within Member States. This is inconsistent with the present *acquis* in Community practice.

5. CONCLUDING REMARKS

While the proposal to establish progressivity in the EU contributions system is prima facie appealing, it has nevertheless some significant drawbacks.

First, it does not respect horizontal equity. This arises from the fact that, instead of calculating contributions according to the true GNP bases, it proposes to establish contributions on different bases, which correspond to an artificial expansion or reduction of the true GNP bases. No tax system in the world knows this procedure. Progressivity in national tax systems is pursued through differential tax parameters without affecting the tax base. Furthermore, in the case of financing the EU the base adjustment can have other unwarranted effects for those Member States around the EU average in GNP per capita terms.

Second, the proposal disregards the importance and the virtue of practising solidarity in the Community through the expenditure side of the EU budget rather than through the equivalent of simple cash transfers. Expenditure-based progressivity enhances the probability of allocating expenditure for the purpose of real convergence, as intended, rather than for the purpose of present, and possibly future, consumption. Thus, the present, rules-based, system produces, in principle, superior convergence outcomes than the proposed alternative.

Third, the present system provides ex ante assurance to the taxpayers of the EU who finance convergence expenditure that the funds are indeed used for the intended purpose.

Finally, the proposal implies higher gross budgetary contributions from those Member States already voicing concerns about their budgetary burden under the present system. One possible outcome would be that the proposal could be acceptable to these Member States if there is a corresponding and offsetting reduction in structural expenditure. Under these circumstances, this will inhibit progress in cohesion and solidarity in the short run and in the long run it reduce the real convergence prospects of the benefiting Member States.

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Statistical Annex

Table 1a

EU expenditure in the Member States: FEOGA Guarantee[1]

	1992		1993		1994		1995		1996		1997	
	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%
B	1 374.2	4.3	1 286.5	3.7	1 174.4	3.5	1 623.4	4.7	1 152.8	2.9	983.4	2.4
DK	1 168.0	3.6	1 318.3	3.8	1 287.9	3.8	1 403.6	4.1	1 358.4	3.5	1 235.7	3.0
D	4 817.6	15.0	4 901.9	14.2	5 271.6	15.7	5 385.1	15.6	6 050.3	15.5	5 778.4	14.2
GR	2 237.4	7.0	2 710.2	7.9	2 723.5	8.1	2 425.5	7.0	2 801.6	7.2	2 730.8	6.7
E	3 668.3	11.4	4 172.7	12.1	4 426.9	13.2	4 575.0	13.3	4 054.6	10.4	4 605.6	11.3
F	6 924.7	21.6	8 072.6	23.4	8 048.8	24.0	8 423.3	24.4	9 572.3	24.5	9 149.0	22.5
IRL	1 435.6	4.5	1 635.8	4.7	1 527.1	4.5	1 419.7	4.1	1 700.0	4.4	2 034.0	5.0
I	5 151.4	16.1	4 825.4	14.0	3 481.4	10.4	3 390.7	9.8	4 231.3	10.8	5 090.8	12.5
L	1.0	0.0	7.3	0.0	12.7	0.0	14.4	0.0	20.0	0.1	22.8	0.1
NL	2 380.6	7.4	2 324.8	6.7	1 935.9	5.8	1 944.6	5.6	1 536.2	3.9	1 757.3	4.3
A	-	-	-	-	-	-	87.5	0.3	1 214.1	3.1	861.3	2.1
P	476.0	1.5	478.1	1.4	713.3	2.1	708.1	2.1	646.0	1.7	656.9	1.6
FIN	-	-	-	-	-	-	63.3	0.2	649.2	1.7	570.6	1.4
S	-	-	-	-	-	-	76.5	0.2	624.1	1.6	747.0	1.8
UK	2 459.4	7.7	2 762.8	8.0	3 001.9	8.9	2 955.9	8.6	3 470.0	8.9	4 399.7	10.8
Total	**32 094.1**	**100.0**	**34 496.4**	**100.0**	**33 605.3**	**100.0**	**34 496.6**	**100.0**	**39 080.9**	**100.0**	**40 623.2**	**100.0**

1) Heading 1 of the Financial Perspective (Subsection B1 of the Community Budget).

Table 1b

EU expenditure in the Member States: Structural Operations[1]

	1992		1993		1994		1995		1996		1997	
	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%
B	236.1	1.4	236.0	1.2	266.0	1.7	236.1	1.2	437.0	1.8	357.9	1.4
DK	66.6	0.4	119.2	0.6	127.3	0.8	120.4	0.6	103.7	0.4	169.6	0.7
D	2 096.6	12.5	1 939.4	10.0	2 041.8	13.0	2 130.1	11.1	3 423.9	14.0	3 636.0	14.0
GR	1 811.3	10.8	2 261.7	11.7	2 034.0	13.0	1 969.1	10.3	2 221.9	9.1	2 643.7	10.2
E	3 704.9	22.1	3 743.8	19.4	3 221.8	20.6	6 101.7	31.9	6 304.8	25.8	6 376.8	24.5
F	1 664.7	9.9	1 891.0	9.8	1 413.6	9.0	1 283.3	6.7	1 958.7	8.0	2 460.3	9.4
IRL	1 075.2	6.4	1 255.2	6.5	794.5	5.1	1 069.1	5.6	1 189.3	4.9	1 211.2	4.7
I	2 196.9	13.1	3 585.9	18.6	1 494.4	9.5	1 926.9	10.1	3 037.1	12.4	2 895.0	11.1
L	13.4	0.1	15.8	0.1	13.9	0.1	16.9	0.1	15.2	0.1	19.9	0.1
NL	136.3	0.8	223.7	1.2	274.6	1.8	231.8	1.2	262.4	1.1	421.3	1.6
A	-	-	-	-	-	-	175.1	0.9	270.6	1.1	364.0	1.4
P	2 316.0	13.8	2 711.4	14.0	2 252.2	14.4	2 485.4	13.0	2 941.3	12.0	2 941.5	11.3
FIN	-	-	-	-	-	-	173.8	0.9	155.9	0.6	379.9	1.5
S	-	-	-	-	-	-	125.6	0.7	132.7	0.5	230.6	0.9
UK	1 462.7	8.7	1 325.7	6.9	1 728.0	11.0	1 103.6	5.8	1 963.9	8.0	1 928.9	7.4
Total	**16 780.8**	**100.0**	**19 308.8**	**100.0**	**15 661.9**	**100.0**	**19 149.0**	**100.0**	**24 418.4**	**100.0**	**26 036.7**	**100.0**

1) Heading 2 of the Financial Perspective.

Table 1c

EU expenditure in the Member States: Internal policies[1]

	1992		1993		1994		1995		1996		1997	
	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%
B	348.6	10.5	414.1	11.8	458.8	14.0	439.4	13.5	524.8	12.6	492.5	10.5
DK	75.3	2.3	101.6	2.9	89.4	2.7	82.9	2.5	122.7	2.9	137.2	2.9
D	437.7	13.1	475.3	13.6	512.9	15.6	493.7	15.2	614.6	14.8	726.7	15.5
GR	260.5	7.8	124.7	3.6	97.6	3.0	106.4	3.3	152.0	3.7	163.7	3.5
E	139.8	4.2	271.1	7.7	216.3	6.6	195.0	6.0	275.6	6.6	296.2	6.3
F	510.6	15.3	466.9	13.3	520.3	15.8	486.5	15.0	579.8	13.9	604.9	12.9
IRL	58.6	1.8	63.7	1.8	76.4	2.3	78.3	2.4	96.9	2.3	105.7	2.3
I	654.0	19.6	656.3	18.8	364.6	11.1	344.7	10.6	496.6	11.9	528.1	11.3
L	38.7	1.2	51.5	1.5	69.9	2.1	75.5	2.3	88.2	2.1	75.6	1.6
NL	173.0	5.2	187.7	5.4	248.0	7.5	210.4	6.5	265.8	6.4	341.9	7.3
A	-	-	-	-	-	-	53.7	1.7	58.7	1.4	78.2	1.7
P	159.0	4.8	162.4	4.6	84.2	2.6	99.6	3.1	103.0	2.5	190.2	4.1
FIN	-	-	-	-	-	-	37.7	1.2	69.9	1.7	88.7	1.9
S	-	-	-	-	-	-	67.3	2.1	108.0	2.6	127.7	2.7
UK	478.6	14.4	524.4	15.0	547.5	16.7	480.7	14.8	606.9	14.6	716.8	15.3
Total	**3 334.3**	**100.0**	**3 499.8**	**100.0**	**3 285.8**	**100.0**	**3 251.9**	**100.0**	**4 163.4**	**100.0**	**4 674.0**	**100.0**

1) Heading 3 of the Financial Perspective.

Table 1d

Operational expenditure in the Member States[1]

	1992		1993		1994		1995		1996		1997	
	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%
B	1 958.9	3.8	1 936.6	3.4	1 899.2	3.6	2 298.9	3.9	2 114.5	3.1	1 833.8	2.6
DK	1 309.8	2.5	1 539.1	2.7	1 504.5	2.9	1 606.9	2.7	1 584.8	2.3	1 542.4	2.2
D	7 351.9	14.1	7 316.7	12.8	7 826.3	14.9	8 008.9	13.7	10 088.8	14.8	10 141.1	14.2
GR	4 309.2	8.3	5 096.7	8.9	4 855.0	9.2	4 501.0	7.7	5 175.5	7.6	5 538.2	7.7
E	7 513.1	14.4	8 187.6	14.3	7 865.0	15.0	10 871.7	18.6	10 635.0	15.6	11 278.6	15.8
F	9 100.0	17.4	10 430.5	18.2	9 982.7	19.0	10 193.2	17.4	12 110.8	17.7	12 214.2	17.1
IRL	2 569.4	4.9	2 954.7	5.2	2 398.0	4.6	2 567.1	4.4	2 986.2	4.4	3 350.9	4.7
I	8 002.3	15.3	9 067.6	15.8	5 340.4	10.2	5 662.3	9.7	7 765.0	11.4	8 514.0	11.9
L	53.1	0.1	74.6	0.1	96.5	0.2	106.8	0.2	123.4	0.2	118.3	0.2
NL	2 689.9	5.2	2 736.2	4.8	2 458.4	4.7	2 386.9	4.1	2 064.3	3.0	2 520.4	3.5
A	-	-	-	-	-	-	899.3	1.5	1 649.4	2.4	1 374.6	1.9
P	2 951.0	5.7	3 351.9	5.8	3 049.6	5.8	3 293.0	5.6	3 690.3	5.4	3 788.6	5.3
FIN	-	-	-	-	-	-	750.8	1.3	1038.0	1.5	1 104.2	1.5
S	-	-	-	-	-	-	757.5	1.3	1296.8	1.9	1 181.3	1.7
UK	4 400.6	8.4	4 612.9	8.0	5 277.4	10.0	4 540.1	7.8	6 040.8	8.8	7 045.4	9.8
Total	**52 209.2**	**100.0**	**57 305.0**	**100.0**	**52 553.1**	**100.0**	**58 444.5**	**100.0**	**68 363.7**	**100.0**	**71 545.9**	**100.0**

1)Table 1d equals the sum of tables 1a, 1b, 1c plus the budgetary compensation for the new Member States

Table 1e

EU expenditure in the Member States: Administrative expenditure[1]

	1992		1993		1994		1995		1996		1997	
	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%
B	1 504.4	58.9	1 791.4	58.9	2 062.6	65.6	2 099.4	61.5	2 052.2	58.5	2 217.1	60.4
DK	20.4	0.8	24.3	0.8	28.3	0.9	33.5	1.0	31.9	0.9	31.9	0.9
D	84.0	3.3	100.0	3.3	74.4	2.4	116.9	3.4	125.6	3.6	132.7	3.6
GR	7.7	0.3	9.1	0.3	11.1	0.4	12.3	0.4	11.5	0.3	12.0	0.3
E	23.0	0.9	27.4	0.9	24.7	0.8	26.7	0.8	26.5	0.8	25.0	0.7
F	74.0	2.9	88.1	2.9	102.9	3.3	143.5	4.2	174.9	5.0	190.6	5.2
IRL	12.8	0.5	15.2	0.5	8.8	0.3	11.2	0.3	11.4	0.3	12.8	0.3
I	45.9	1.8	54.7	1.8	53.2	1.7	78.7	2.3	87.2	2.5	91.8	2.5
L	696.6	27.3	829.4	27.3	676.4	21.5	754.9	22.1	825.0	23.5	777.8	21.2
NL	25.5	1.0	30.4	1.0	24.6	0.8	41.5	1.2	39.4	1.1	41.0	1.1
A	-	-	-	-	-	-	3.0	0.1	11.1	0.3	12.2	0.3
P	12.8	0.5	15.2	0.5	10.9	0.3	13.0	0.4	11.2	0.3	11.0	0.3
FIN	-	-	-	-	-	-	2.6	0.1	14.0	0.4	13.8	0.4
S	-	-	-	-	-	-	3.1	0.1	15.7	0.4	15.3	0.4
UK	45.7	1.8	54.4	1.8	66.0	2.1	72.3	2.1	71.6	2.0	83.9	2.3
Total	**2 552.4**	**100.0**	**3 039.3**	**100.0**	**3 143.8**	**100.0**	**3 412.6**	**100.0**	**3 509.0**	**100.0**	**3 669.1**	**100.0**

1) Heading 5 of the Financial Perspective.

Table 1f

Total EU expenditure[1]

	1992		1993		1994		1995		1996		1997	
	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%
B	3 463.3	5.9	3 728.0	5.8	3 961.8	6.6	4 398.3	6.6	4 166.8	5.4	4 050.9	5.0
DK	1 330.3	2.3	1 563.4	2.4	1 532.8	2.5	1 640.4	2.5	1 616.7	2.1	1 574.4	2.0
D	7 435.9	12.7	7 416.7	11.6	7 900.6	13.1	8 125.7	12.1	10 214.4	13.3	10 273.8	12.8
GR	4 316.9	7.4	5 105.8	8.0	4 866.2	8.1	4 513.4	6.7	5 187.0	6.7	5 550.2	6.9
E	7 536.0	12.9	8 215.0	12.8	7 889.7	13.1	10 898.4	16.3	10 661.5	13.9	11 303.6	14.1
F	9 174.1	15.6	10 518.7	16.4	10 085.6	16.7	10 336.7	15.5	12 285.7	16.0	12 404.8	15.5
IRL	2 582.2	4.4	2 969.9	4.6	2 406.8	4.0	2 578.3	3.9	2 997.7	3.9	3 363.7	4.2
I	8 048.2	13.7	9 122.3	14.2	5 393.5	8.9	5 741.0	8.6	7 852.2	10.2	8 605.8	10.7
L	749.7	1.3	904.0	1.4	772.9	1.3	861.7	1.3	948.4	1.2	896.1	1.1
NL	2 715.4	4.6	2 766.6	4.3	2 483.1	4.1	2 428.3	3.6	2 103.7	2.7	2 561.4	3.2
A	-	-	-	-	-	-	902.3	1.3	1 660.5	2.2	1 386.8	1.7
P	2 963.8	5.1	3 367.1	5.2	3 060.5	5.1	3 306.0	4.9	3 701.4	4.8	3 799.6	4.7
FIN	-	-	-	-	-	-	753.4	1.1	1 052.0	1.4	1 118.0	1.4
S	-	-	-	-	-	-	760.7	1.1	1 312.5	1.7	1 196.6	1.5
UK	4 446.4	7.6	4 667.3	7.3	5 343.4	8.9	4 612.4	6.9	6 112.4	8.0	7 129.3	8.9
Tot. EU	**54 761.7**	**93.4**	**60 344.3**	**94.1**	**55 696.9**	**92.4**	**61 857.1**	**92.5**	**71 872.7**	**93.5**	**75 214.9**	**93.7**
Non-EU[2]	3 864.7	6.6	3 807.5	5.9	4 607.8	7.6	5 043.9	7.5	4 993.9	6.5	5 021.5	6.3
Total	**58 626.4**	**100.0**	**64 152.2**	**100.0**	**60 304.8**	**100.0**	**66 901.0**	**100.0**	**76 866.6**	**100.0**	**80 236.4**	**100.0**

1) Heading 1 – Heading 7 of the Financial Perspective (the flows taken into account are those which actually took place during the year, i.e. appropriations used in a given financial year and those carried over from year n-1), not included is the cash balance at the end of a period. 2) Expenditure made outside the EU, guarantees and reserves plus some minor amounts which cannot be allocated.

Table 2a

Payments to the EU budget: Traditional own resources[1]

	1992		1993		1994		1995		1996		1997		1998[2]		1999[2]	
	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus		Mecus		Meuros	%
B	887.1	6.7	873.7	6.7	958.5	7.2	1 003.5	6.9	985.9	7.3	1 048.9	7.4	1 079.6	7.9	1 128.6	8.2
DK	272.9	2.1	260.5	2.0	275.7	2.1	286.4	2.0	265.6	2.0	288.6	2.0	293.9	2.1	287.4	2.1
D	3 928.9	29.6	3 894.0	30.0	3 872.7	29.2	3 879.9	26.8	3 500.2	25.8	3 432.5	24.2	3 280.8	23.9	3 216.2	23.3
GR	173.4	1.3	176.5	1.4	150.3	1.1	152.2	1.1	149.8	1.1	163.7	1.1	167.5	1.2	161.4	1.2
E	775.1	5.8	597.7	4.6	592.7	4.5	727.1	5.0	622.6	4.6	631.7	4.5	695.4	5.1	709.5	5.1
F	1 680.4	12.7	1 695.2	13.1	1 683.0	12.7	1 711.4	11.8	1 542.6	11.4	1 550.8	10.9	1 566.5	11.4	1 546.8	11.2
IRL	156.2	1.2	186.0	1.4	219.0	1.7	228.1	1.6	206.7	1.5	224.7	1.6	220.2	1.6	214.9	1.6
I	1 318.1	9.9	1 134.4	8.7	1 155.2	8.7	1 186.0	8.2	1 047.5	7.7	1 120.4	7.9	1 103.8	8.0	1 205.6	8.7
L	15.2	0.1	15.2	0.1	18.1	0.1	19.9	0.1	18.3	0.1	22.0	0.2	20.8	0.2	19.9	0.1
NL	1 455.1	11.0	1 470.8	11.3	1 546.9	11.7	1 663.7	11.5	1 609.3	11.8	1 728.5	12.2	1 597.4	11.6	1 589.3	11.5
A	-	-	-	-	-	-	221.9	1.5	263.8	1.9	254.4	1.8	257.2	1.9	273.2	2.0
P	209.4	1.6	188.2	1.5	202.8	1.5	205.8	1.4	135.6	1.0	155.1	1.1	160.2	1.2	167.7	1.2
FIN	-	-	-	-	-	-	137.1	0.9	151.8	1.1	144.3	1.0	138.8	1.0	128.8	0.9
S	-	-	-	-	-	-	351.3	2.4	383.5	2.8	362.9	2.6	365.9	2.7	381.5	2.8
UK	2 408.3	18.1	2 493.2	19.2	2 577.2	19.5	2 678.8	18.5	2 700.2	19.9	3 043.9	21.5	2 795.1	20.3	2 784.2	20.2
Total	**13 280.2**	**100.0**	**12 985.5**	**100.0**	**13 252.2**	**100.0**	**14 453.2**	**100.0**	**13 583.6**	**100.0**	**14 172.3**	**100.0**	**13 743.2**	**100.0**	**13 814.9**	**100.0**

1) Customs duties, agricultural duties and sugar levies after deduction of the collection fees.

2) Figures entered into the draft SAB for 1998 and the draft budget for 1999

Table 2b

Payments to the EU budget: VAT own resource [1]

	1992		1993		1994		1995		1996		1997		1998[2]		1999[2]	
	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus		Mecus		Meuros	%
B	982.8	2.8	910.0	2.6	1 121.6	3.4	1 143.4	2.9	951.5	2.6	907.0	2.6	851.3	2.6	782.5	2.6
DK	537.0	1.5	558.9	1.6	580.3	1.8	691.7	1.8	619.3	1.7	616.3	1.8	569.7	1.7	529.9	1.7
D	10 329.2	29.7	9 897.4	28.5	11 419.9	34.4	12 862.1	32.9	10 885.4	29.8	10 009.9	29.1	8 786.0	26.8	8 079.0	26.6
GR	431.1	1.2	568.8	1.6	535.2	1.6	584.4	1.5	556.1	1.5	552.3	1.6	541.8	1.7	467.6	1.5
E	3 082.5	8.9	2 965.1	8.5	2 469.6	7.4	2 058.9	5.3	2 327.5	6.4	2 576.3	7.5	2 226.4	6.8	2 082.3	6.9
F	6 585.6	18.9	6 018.9	17.4	6 633.4	20.0	7 216.5	18.4	6 452.3	17.7	6 282.3	18.3	5 663.6	17.3	5 192.7	17.1
IRL	233.9	0.7	258.8	0.7	277.1	0.8	321.0	0.8	315.1	0.9	250.8	0.7	279.5	0.9	265.8	0.9
I	4 857.1	14.0	5 593.8	16.1	3 725.7	11.2	3 377.2	8.6	4 450.0	12.2	3 447.6	10.0	3 661.2	11.2	3 390.0	11.2
L	83.9	0.2	106.3	0.3	95.6	0.3	109.0	0.3	89.7	0.2	82.5	0.2	75.8	0.2	70.0	0.2
NL	1 553.7	4.5	1 624.7	4.7	1 648.5	5.0	1 887.3	4.8	1 663.5	4.6	1 681.2	4.9	1 549.1	4.7	1 439.8	4.7
A	-	-	-	-	-	-	1 105.6	2.8	947.2	2.6	1 035.6	3.0	894.3	2.7	825.3	2.7
P	487.5	1.4	477.1	1.4	689.5	2.1	488.2	1.3	465.7	1.3	530.3	1.5	431.9	1.3	413.5	1.4
FIN	-	-	-	-	-	-	529.2	1.4	444.8	1.2	469.5	1.4	421.9	1.3	389.4	1.3
S	-	-	-	-	-	-	891.3	2.3	900.6	2.5	1 084.7	3.2	861.8	2.6	816.2	2.7
UK	5 598.7	16.1	5 709.4	16.5	4 021.4	12.1	5 861.6	15.0	5 466.5	15.0	4 825.3	14.0	5 938.6	18.1	5 630.2	18.5
Total	**34 763.2**	**100.0**	**34 689.3**	**100.0**	**33 217.9**	**100.0**	**39 127.3**	**100.0**	**36 535.0**	**100.0**	**34 351.5**	**100.0**	**32 752.8**	**100.0**	**30 374.2**	**100.0**

1) VAT own resources payments at the uniform rate (excluding the UK correction); balances of VAT own resources for previous years are included.

2) Figures entered into the draft SAB for 1998 and the draft budget for 1999

Table 2c

Payments to the EU budget: GNP own resource [1]

	1992		1993		1994		1995		1996		1997		1998[2]		1999[2]	
	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus		Mecus		Meuros	%
B	255.5	3.1	484.7	3.0	636.8	3.6	467.4	3.3	693.2	3.3	917.9	3.4	1 090.6	3.0	1 243.6	3.0
DK	154.0	1.9	306.0	1.9	374.7	2.1	275.9	1.9	408.5	1.9	538.2	2.0	714.2	2.0	825.4	2.0
D	2 188.1	26.8	4 617.2	28.1	5 537.3	31.4	4 243.9	29.9	5 745.3	27.3	7 281.3	27.1	9 208.4	25.6	10 503.8	25.3
GR	82.2	1.0	217.9	1.3	267.0	1.5	221.4	1.6	345.8	1.6	416.4	1.5	555.7	1.5	591.6	1.4
E	671.4	8.2	1 290.2	7.9	1 392.6	7.9	723.9	5.1	1 350.7	6.4	1 940.0	7.2	2 381.2	6.6	2 764.1	6.7
F	1 543.4	18.9	3 037.4	18.5	3 600.8	20.4	2 569.9	18.1	3 741.9	17.8	4 793.1	17.8	6 159.4	17.1	7 061.2	17.0
IRL	50.8	0.6	99.0	0.6	123.4	0.7	102.5	0.7	133.2	0.6	190.3	0.7	286.6	0.8	336.3	0.8
I	1 469.8	18.0	2 800.8	17.1	2 370.1	13.4	1 586.6	11.2	2 959.8	14.0	3 666.2	13.6	5 058.4	14.1	5 798.3	14.0
L	17.5	0.2	37.5	0.2	44.8	0.3	34.2	0.2	44.5	0.2	59.5	0.2	76.2	0.2	88.5	0.2
NL	367.1	4.5	746.3	4.5	898.0	5.1	704.1	5.0	990.1	4.7	1 283.1	4.8	1 635.5	4.5	1 883.0	4.5
A	-	-	-	-	-	-	378.8	2.7	559.5	2.7	738.0	2.7	910.5	2.5	1 046.7	2.5
P	99.7	1.2	193.5	1.2	279.2	1.6	145.5	1.0	202.3	1.0	353.0	1.3	442.9	1.2	523.1	1.3
FIN	-	-	-	-	-	-	192.4	1.4	312.5	1.5	402.8	1.5	519.3	1.4	599.2	1.4
S	-	-	-	-	-	-	361.9	2.6	582.5	2.8	793.0	2.9	974.8	2.7	1 142.8	2.8
UK	1 268.8	15.5	2 584.0	15.7	2 132.1	12.1	2 179.3	15.4	2 997.2	14.2	3 517.8	13.1	5 971.4	16.6	7 122.8	17.2
Total	**8 168.2**	**100.0**	**16 414.4**	**100.0**	**17 657.0**	**100.0**	**14 187.7**	**100.0**	**21 067.1**	**100.0**	**26 890.6**	**100.0**	**35 985.2**	**100.0**	**41 530.4**	**100.0**

1) including "reserves" and balances of GNP own resources for previous years

2) Figures entered into the draft SAB for 1998 and the draft budget for 1999

Table 2d

Payments to the EU budget: Correction of budgetary imbalances[1]

	1992		1993		1994		1995		1996		1997		1998[4]		1999[4]	
	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus		Mecus		Meuros	%
B	113.7	4.4	126.5	4.0	105.2	4.5	65.8	4.5	120.4	4.1	97.7	4.0	134.7	4.2	162.9	4.1
DK	71.0	2.8	81.1	2.6	65.5	2.8	41.4	2.8	75.5	2.6	62.7	2.5	88.2	2.7	108.1	2.8
D[2]	551.2	21.4	667.9	21.1	536.4	23.2	338.1	23.0	611.7	20.8	493.6	20.1	660.8	20.5	800.1	20.4
GR	41.9	1.6	47.9	1.5	39.7	1.7	27.1	1.8	54.2	1.8	46.0	1.9	68.6	2.1	77.5	2.0
E	299.0	11.6	339.6	10.7	263.2	11.4	135.3	9.2	246.4	8.4	219.6	8.9	294.1	9.1	362.1	9.2
F	683.9	26.6	794.0	25.1	633.6	27.4	378.9	25.8	686.5	23.3	559.7	22.8	760.8	23.5	924.9	23.5
IRL	21.5	0.8	23.6	0.7	19.5	0.8	13.2	0.9	26.5	0.9	21.2	0.9	35.4	1.1	44.1	1.1
I	634.8	24.7	736.1	23.3	508.6	22.0	263.9	18.0	547.3	18.6	432.8	17.6	624.8	19.3	759.5	19.3
L	6.9	0.3	8.0	0.3	6.9	0.3	4.6	0.3	8.1	0.3	6.7	0.3	9.4	0.3	11.6	0.3
NL	158.0	6.1	188.8	6.0	152.5	6.6	94.5	6.4	172.6	5.9	144.9	5.9	202.0	6.3	246.6	6.3
A	-	-	-	-	-	-	56.6	3.9	103.5	3.5	82.4	3.4	112.5	3.5	137.1	3.5
P	41.5	1.6	50.6	1.6	44.1	1.9	25.4	1.7	48.2	1.6	39.4	1.6	54.7	1.7	68.5	1.7
FIN	-	-	-	-	-	-	28.8	2.0	55.0	1.9	45.3	1.8	64.1	2.0	78.5	2.0
S	-	-	-	-	-	-	53.8	3.7	102.4	3.5	85.4	3.5	120.4	3.7	149.7	3.8
UK	- 2 573.3	-100.0	- 3 160.0	-100.0	- 2 313.3	-100.0	- 1 468.1	-100.0	- 2 945.3	-100.0	- 2 458.8	-100.0	-3 230.6	-100.0	-3 931.2	-100.0
Total[3]	**50.1**	**1.9**	**- 96.0**	**- 3.0**	**61.8**	**2.7**	**59.4**	**4.0**	**- 87.0**	**- 3.0**	**- 121.4**	**- 4.9**	**0.0**	**0.0**	**0.0**	**0.0**

1) The figures include the financing of the UK correction for the previous year as well as the adjustment of that for the year "n-4".

2) The share of Germany in financing the UK rebate is restricted to two-thirds of its normal share.

3) Variations in exchange rates, "reserves" and balances of GNP own resources from previous years explain the non-zero sum in the total in certain years.

4) Figures entered into the draft SAB for 1998 and the draft budget for 1999.

ANNEX 8

Table 2e

Own resources: National contributions[1]

	1992		1993		1994		1995		1996		1997		1998[2]		1999[2]	
	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus		Mecus		Meuros	%
B	1 352.0	3.1	1 521.3	3.0	1 863.6	3.7	1 676.6	3.1	1 765.1	3.1	1 922.5	3.1	2 076.7	3.0	2 189.1	3.0
DK	762.0	1.8	946.0	1.9	1 020.5	2.0	1 009.0	1.9	1 103.3	1.9	1 217.2	2.0	1 372.2	2.0	1 463.4	2.0
D	13 068.5	30.4	15 182.4	29.8	17 493.7	34.3	17 444.1	32.7	17 242.4	30.0	17 784.7	29.1	18 655.2	27.1	19 382.9	27.0
GR	555.3	1.3	834.6	1.6	842.0	1.7	833.0	1.6	956.1	1.7	1 014.7	1.7	1 166.1	1.7	1 136.7	1.6
E	4 052.9	9.4	4 594.9	9.0	4 125.4	8.1	2 918.1	5.5	3 924.6	6.8	4 736.0	7.7	4 901.7	7.1	5 208.5	7.2
F	8 813.0	20.5	9 850.3	19.3	10 867.9	21.3	10 165.4	19.0	10 880.7	18.9	11 635.1	19.0	12 583.7	18.3	13 178.9	18.3
IRL	306.1	0.7	381.4	0.7	419.9	0.8	436.7	0.8	474.8	0.8	462.3	0.8	601.5	0.9	646.2	0.9
I	6 961.8	16.2	9 130.6	17.9	6 604.4	13.0	5 227.7	9.8	7 957.1	13.8	7 546.7	12.3	9 344.5	13.6	9 947.8	13.8
L	108.3	0.3	151.8	0.3	147.3	0.3	147.7	0.3	142.3	0.2	148.7	0.2	161.4	0.2	170.0	0.2
NL	2 078.8	4.8	2 559.9	5.0	2 699.0	5.3	2 685.9	5.0	2 826.2	4.9	3 109.2	5.1	3 386.6	4.9	3 569.4	5.0
A	0.0	0.0	0.0	0.0	0.0	0.0	1 541.0	2.9	1 610.2	2.8	1 856.0	3.0	1 917.2	2.8	2 009.1	2.8
P	628.7	1.5	721.3	1.4	1 012.8	2.0	659.1	1.2	716.1	1.2	922.7	1.5	929.5	1.4	1 005.2	1.4
FIN	0.0	0.0	0.0	0.0	0.0	0.0	750.3	1.4	812.2	1.4	917.6	1.5	1 005.3	1.5	1 067.0	1.5
S	0.0	0.0	0.0	0.0	0.0	0.0	1 307.0	2.4	1 585.6	2.8	1 963.1	3.2	1 957.0	2.8	2 108.7	2.9
UK	4 294.1	10.0	5 133.4	10.1	3 840.2	7.5	6 572.8	12.3	5 518.3	9.6	5 884.2	9.6	8 679.4	12.6	8 821.7	12.3
Total	**42 981.5**	**100.0**	**51 007.7**	**100.0**	**50 936.7**	**100.0**	**53 374.4**	**100.0**	**57 515.1**	**100.0**	**61 120.7**	**100.0**	**68 738.0**	**100.0**	**71 904.6**	**100.0**

1) Sum of tables 2b, 2c and 2d including "reserves" and balances of GNP own resources for previous years

2) Figures entered into the draft SAB for 1998 and the draft budget for 1999

ANNEX 8

Table 2f

Total own resources[1]

	1992		1993		1994		1995		1996		1997		1998[2]		1999[2]	
	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus		Mecus		Meuros	%
B	2 239.1	4.0	2 394.9	3.7	2 822.1	4.4	2 680.1	4.0	2 750.9	3.9	2 971.4	3.9	3 156.3	3.8	3 317.7	3.9
DK	1 034.8	1.8	1 206.5	1.9	1 296.2	2.0	1 295.4	1.9	1 368.9	1.9	1 505.8	2.0	1 666.0	2.0	1 750.8	2.0
D	16 997.5	30.2	19 076.4	29.8	21 366.3	33.3	21 324.1	31.4	20 742.6	29.2	21 217.3	28.2	21 935.9	26.6	22 599.1	26.4
GR	728.6	1.3	1 011.2	1.6	992.3	1.5	985.2	1.5	1 106.0	1.6	1 178.4	1.6	1 333.5	1.6	1 298.1	1.5
E	4 828.0	8.6	5 192.6	8.1	4 718.1	7.4	3 645.2	5.4	4 547.2	6.4	5 367.6	7.1	5 597.1	6.8	5 918.0	6.9
F	10 493.4	18.7	11 545.5	18.0	12 550.9	19.5	11 876.8	17.5	12 423.3	17.5	13 185.9	17.5	14 150.3	17.2	14 725.7	17.2
IRL	462.3	0.8	567.4	0.9	638.9	1.0	664.8	1.0	681.5	1.0	687.0	0.9	821.7	1.0	861.1	1.0
I	8 279.9	14.7	10 265.0	16.0	7 759.6	12.1	6 413.7	9.5	9 004.7	12.7	8 667.1	11.5	10 448.2	12.7	11 153.5	13.0
L	123.5	0.2	167.0	0.3	165.4	0.3	167.6	0.3	160.7	0.2	170.7	0.2	182.2	0.2	189.9	0.2
NL	3 534.0	6.3	4 030.6	6.3	4 245.9	6.6	4 349.6	6.4	4 435.5	6.2	4 837.6	6.4	4 984.0	6.0	5 158.7	6.0
A	-	-	-	-	-	-	1 762.9	2.6	1 874.0	2.6	2 110.4	2.8	2 174.4	2.6	2 282.2	2.7
P	838.1	1.5	909.4	1.4	1 215.6	1.9	864.9	1.3	851.7	1.2	1 077.8	1.4	1 089.7	1.3	1 172.8	1.4
FIN	-	-	-	-	-	-	887.4	1.3	964.0	1.4	1 061.9	1.4	1 144.1	1.4	1 195.8	1.4
S	-	-	-	-	-	-	1 658.3	2.4	1 969.0	2.8	2 326.0	3.1	2 323.0	2.8	2 490.2	2.9
UK	6 702.4	11.9	7 626.6	11.9	6 417.4	10.0	9 251.6	13.6	8 218.6	11.6	8 928.1	11.9	11 474.5	13.9	11 605.9	13.5
Total	**56 261.7**	**100.0**	**63 993.2**	**100.0**	**64 188.8**	**100.0**	**67 827.6**	**100.0**	**71 098.7**	**100.0**	**75 293.0**	**100.0**	**82 481.1**	**100.0**	**85 719.5**	**100.0**

1) Sum of tables 2a, 2b, 2c and 2d including "reserves" and balances of GNP own resources for previous years

2) Figures entered into the draft SAB for 1998 and the draft budget for 1999

7-10-1998

Table 3a

Structure of EU expenditure

	1992		1993		1994		1995		1996		1997	
	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%
EAGGF guarantee	31 234.3	53.3	34 423.3	53.7	33 605.3	55.7	34 497.7	51.6	39 080.9	50.8	40 623.2	50.6
Structural Funds	17 748.8	30.3	20 084.8	31.3	15 767.0	26.2	19 292.0	28.8	24 426.8	31.8	26 059.2	32.5
Internal policies	4 008.3	6.8	3 618.0	5.6	3 907.1	6.5	4 004.5	6.0	4 544.4	5.9	4 934.7	6.2
External expenditure	1 857.5	3.2	2 718.1	4.2	3 459.7	5.7	3 700.2	5.5	4 040.1	5.3	4 278.0	5.3
Administrative expenditure	2 900.9	5.0	3 308.0	5.2	3 565.6	5.9	3 859.7	5.8	4 073.3	5.3	4 129.2	5.1
Compensations to MS	876.8	1.5	0.0	0.0	0.0	0.0	1 547.0	2.3	701.0	0.9	212.0	0.3
Total	**58 626.6**	**100.0**	**64 152.2**	**100.0**	**60 304.8**	**100.0**	**66 901.0**	**100.0**	**76 866.6**	**100.0**	**80 236.4**	**100.0**
Rate of increase	+ 8.6 %		+ 9.4 %		- 6.0 %		+ 10.9 %		+ 14.9 %		+ 4.4 %	

Table 3b

Structure of payments to the EU budget

	1992		1993		1994		1995		1996		1997		1998[2]		1999[2]	
	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus	%	Mecus		Mecus		Meuros	%
TOR	13 280.2	23.6	12 985.5	20.3	13 252.2	20.6	14 453.2	21.3	13 583.6	19.1	14 172.3	18.8	13 743.2	16.7	13 814.9	16.1
VAT	34 763.2	61.8	34 689.3	54.2	33 217.9	51.8	39 127.3	57.7	36 535.0	51.4	34 351.5	45.6	32 752.8	39.7	30 374.2	35.4
GNP	8 168.2	14.5	16 414.4	25.7	17 657.0	27.5	14 187.7	20.9	21 067.1	29.6	26 890.6	35.7	35 985.2	43.6	41 530.4	48.4
UK rebate	50.1	0.1	- 96.0	- 0.2	61.8	0.1	59.4	0.1	- 87.0	- 0.1	- 121.4	- 0.2	0.0	0.0	0.0	0.0
Total OR	**56 261.7**	**100.0**	**63 993.2**	**100.0**	**64 188.8**	**100.0**	**67 827.6**	**100.0**	**71 098.7**	**100.0**	**75 293.0**	**100.0**	**82 481.1**	**100.0**	**85 719.5**	**100.0**
%increase	+ 6.5 %		+ 13.7 %		+ 0.3 %		+ 5.7 %		+ 4.8 %		+ 5.9 %		+9.5%		+3.9%	
Other Revenue [1]	3 450.1	—	1 679.5	—	1 813.3	—	7 249.5	—	10 176.4	—	5 254.7	—	1 628.0	—	630.9	—
Total	**59 711.8**	—	**65 672.7**	—	**66 002.1**	—	**75 077.1**	—	**81 275.1**	—	**80 547.7**	—	**84 109.1**	—	**86 350.4**	—

1) Other miscellaneous revenues, such as surpluses from previous years, interests on late payments, fines, taxes on salaries of the employees of European Institutions, proceeds from borrowing and lending operations, etc.

2) Figures entered into the draft SAB for 1998 and the draft budget for 1999

Table 3c

Member States shares in EU financing and in EU-15 GNP

(in percent of total, data for 1997)

	B	DK	D	GR	E	F	IRL	I	L	NL	A	P	FIN	S	UK
Financing share	**3.9**	**2.0**	**28.2**	**1.6**	**7.1**	**17.5**	**0.9**	**11.5**	**0.2**	**6.4**	**2.8**	**1.4**	**1.4**	**3.1**	**11.9**
➲ *TOR*	*7.4*	*2.0*	*24.2*	*1.2*	*4.5*	*10.9*	*1.6*	*7.9*	*0.2*	*12.2*	*1.8*	*1.1*	*1.0*	*2.6*	*21.5*
➲ *VAT/GNP*	*3.1*	*2.0*	*29.1*	*1.7*	*7.8*	*19.0*	*0.8*	*12.4*	*0.2*	*5.1*	*3.0*	*1.5*	*1.5*	*3.2*	*9.6*
GNP share	**3.1**	**1.9**	**26.0**	**1.5**	**6.6**	**17.2**	**0.8**	**14.2**	**0.2**	**4.5**	**2.6**	**1.2**	**1.4**	**2.7**	**16.1**

Table 4

Accounting budgetary balances[1]: "Table 1f" less "Table 2f"

	1992		1993		1994		1995		1996		1997	
	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP
B	1 224.2	0.71	1 333.1	0.72	1 139.6	0.58	1 718.2	0.81	1 415.8	0.66	1 079.5	0.50
DK	295.4	0.29	356.9	0.33	236.6	0.20	345.1	0.27	247.8	0.19	68.6	0.05
D	- 9 561.6	-0.62	-11 659.7	- 0.71	-13 465.7	- 0.78	-13 198.3	- 0.72	-10 528.3	- 0.57	-10 943.5	- 0.60
GR	3 588.2	4.66	4 094.7	5.17	3 873.9	4.62	3 528.5	3.99	4 081.0	4.20	4 371.8	4.13
E	2 708.1	0.61	3 022.4	0.74	3 171.6	0.79	7 253.2	1.70	6 114.3	1.34	5 936.0	1.28
F	- 1 319.3	- 0.13	- 1 026.9	- 0.10	- 2 465.3	- 0.22	- 1 540.1	- 0.13	- 137.6	- 0.01	- 781.1	- 0.06
IRL	2 119.8	5.88	2 402.5	6.58	1 767.9	4.45	1 913.7	4.48	2 316.1	4.86	2 676.7	4.84
I	- 231.7	- 0.03	- 1 142.8	- 0.14	- 2 366.0	- 0.28	- 672.7	- 0.08	- 1 152.5	- 0.12	- 61.3	- 0.01
L	626.2	5.24	737.0	5.91	607.6	4.55	694.1	4.88	787.8	5.49	725.4	4.89
NL	- 818.6	- 0.33	- 1 263.9	- 0.48	- 1 762.9	- 0.62	- 1 921.2	- 0.64	- 2 331.8	- 0.75	- 2 276.2	- 0.71
A	-	-	-	-	-	-	- 860.5	- 0.49	- 213.5	- 0.12	- 723.6	- 0.40
P	2 124.4	2.93	2 457.7	3.44	1 844.9	2.50	2 441.1	3.08	2 849.7	3.41	2 721.8	3.12
FIN	-	-	-	-	-	-	- 133.9	- 0.14	88.0	0.09	56.1	0.06
S	-	-	-	-	-	-	- 897.7	- 0.53	- 656.6	- 0.35	- 1 129.5	- 0.59
UK	- 2 256.1	- 0.28	- 2 959.3	- 0.37	- 1 074.0	- 0.13	- 4 639.1	- 0.55	- 2 106.1	- 0.23	- 1 798.8	- 0.16
Total	**- 1 501.2**	**- 0.03**	**- 3 648.6**	**- 0.07**	**- 8 491.9**	**- 0.15**	**- 5 969.7**	**- 0.09**	**774.0**	**0.01**	**- 78.0**	**- 0.00**

(1) For an explanation of the concepts see Annex 3.

Table 5

Operational budgetary balances[1]: "Table 1d" less "Table 2f"

	1992		1993		1994		1995		1996		1997	
	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP
B	-280.2	-0.16	-458.3	-0.25	-922.9	-0.47	-381.2	-0.18	-636.4	-0.30	-1 137.6	-0.52
DK	275.0	0.27	332.7	0.30	208.3	0.18	311.5	0.25	215.9	0.16	36.6	0.03
D	-9 645.6	-0.62	-11 759.7	-0.72	-13 540.0	-0.78	-13 315.2	-0.72	-10 653.8	-0.58	-11 076.2	-0.60
GR	3 580.6	4.65	4 085.5	5.16	3 862.7	4.61	3 515.8	3.98	4 069.6	4.19	4 359.8	4.12
E	2 685.1	0.60	2 995.0	0.73	3 146.9	0.78	7 226.5	1.69	6 087.8	1.34	5 911.0	1.27
F	-1 393.4	-0.14	-1 115.0	-0.11	-2 568.2	-0.23	-1 683.6	-0.14	-312.5	-0.03	-971.7	-0.08
IRL	2 107.1	5.84	2 387.3	6.54	1 759.1	4.42	1 902.3	4.45	2 304.7	4.84	2 663.9	4.82
I	-277.6	-0.03	-1 197.4	-0.14	-2 419.2	-0.29	-751.4	-0.09	-1 239.7	-0.13	-153.1	-0.02
L	-70.4	-0.59	-92.4	-0.74	-68.9	-0.52	-60.8	-0.43	-37.3	-0.26	-52.4	-0.35
NL	- 844.1	-0.34	-1 294.4	-0.49	-1 787.5	-0.63	-1 962.7	-0.65	-2 371.2	-0.76	-2 317.2	-0.73
A	-	-	-	-	-	-	- 863.6	-0.49	-224.6	-0.12	-735.8	-0.41
P	2 112.9	2.91	2 442.4	3.42	1 834.0	2.48	2 428.1	3.06	2 838.6	3.40	2 710.8	3.11
FIN	-	-	-	-	-	-	-136.6	-0.15	74.0	0.08	42.3	0.04
S	-	-	-	-	-	-	- 900.8	-0.53	- 672.2	-0.35	-1 144.7	-0.59
UK	-2 301.8	-0.29	-3 013.7	-0.38	-1 140.0	-0.13	-4 711.5	-0.56	-2 177.8	-0.24	-1 882.7	-0.17
Total	**-4 052.5**	**-0.07**	**-6 688.2**	**-0.12**	**-11 635.7**	**-0.20**	**-9 383.1**	**-0.15**	**-2 735.0**	**-0.04**	**-3 747.1**	**-0.05**

(1) For an explanation of the concepts see Annex 3.

Table 6a

"UK rebate" budgetary balance (before UK correction)[1]

	1992		1993		1994		1995		1996		1997	
	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP
B	1 884.9	1.09	2 078.9	1.13	2 037.5	1.03	2 530.5	1.20	2 113.4	0.99	1 809.7	0.83
DK	448.8	0.43	540.3	0.49	488.6	0.42	518.2	0.41	333.0	0.25	156.5	0.11
D	- 8 515.9	-0.55	- 9 762.2	-0.60	-10 643.8	- 0.62	-11 704.5	- 0.64	-10 559.3	- 0.57	-10 962.5	- 0.60
GR	3 665.2	4.76	4 176.6	5.27	3 990.2	4.76	3 580.3	4.05	4 058.8	4.18	4 360.5	4.12
E	2 759.5	0.62	3 207.7	0.79	3 665.6	0.91	7 674.3	1.80	6 067.1	1.33	5 756.9	1.24
F	- 1 194.6	- 0.12	- 201.2	- 0.02	- 1 104.7	- 0.10	- 1 009.0	- 0.09	- 448.8	- 0.04	- 1 197.6	- 0.10
IRL	2 219.4	6.15	2 548.7	6.98	1 969.0	4.95	2 087.9	4.88	2 436.5	5.11	2 822.0	5.11
I	3.1	0.00	- 784.4	- 0.09	- 1 274.2	- 0.15	6.0	0.00	- 1 440.4	- 0.15	- 131.2	- 0.01
L	620.4	5.19	733.9	5.88	619.3	4.64	695.7	4.90	780.8	5.44	721.7	4.87
NL	267.0	0.11	- 40.5	- 0.02	- 301.7	- 0.11	- 576.4	- 0.19	- 1 209.5	- 0.39	- 1 079.1	- 0.34
A	-	-	-	-	-	-	- 818.8	- 0.46	- 220.9	- 0.12	- 791.5	- 0.44
P	2 214.2	3.05	2 576.9	3.61	2 001.4	2.71	2 571.7	3.24	2 866.7	3.43	2 714.8	3.12
FIN	-	-	-	-	-	-	- 83.2	- 0.09	107.2	0.11	46.7	0.05
S	-	-	-	-	-	-	- 691.0	- 0.41	- 543.3	- 0.29	- 1 109.6	- 0.58
UK	- 4 371.7	- 0.54	- 5 074.4	- 0.63	- 1 447.1	- 0.17	- 4 781.7	- 0.57	- 4 341.2	- 0.48	- 3 117.3	- 0.27
Total	**0.0**	**---**	**0.0**	**---**	**0.0**	**---**	**0.0**	**---**	**0.0**	**---**	**0.0**	**---**

1) Simplified calculation, see Annex 3, point 4.1.

Table 6b

"UK rebate" budgetary balance (after UK correction)(1)

	1992		1993		1994		1995		1996		1997	
	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP
B	1 740.8	1.00	1 928.4	1.05	1 924.0	0.97	2 455.2	1.16	1 961.1	0.91	1 712.0	0.79
DK	359.5	0.35	444.3	0.41	417.0	0.36	471.1	0.37	238.0	0.18	93.8	0.07
D	- 9 214.4	-0.59	-10 544.8	-0.64	-11 227.9	- 0.65	-12 090.9	- 0.66	-11 332.3	- 0.62	-11 456.1	- 0.62
GR	3 609.4	4.69	4 118.4	5.20	3 945.5	4.71	3 548.2	4.02	3 992.2	4.11	4 314.5	4.07
E	2 372.4	0.53	2 779.0	0.68	3 378.8	0.84	7 516.4	1.76	5 757.2	1.26	5 537.2	1.19
F	- 2 054.3	- 0.20	- 1 134.7	- 0.11	- 1 798.0	- 0.16	- 1 444.3	- 0.12	- 1 311.2	- 0.11	- 1 757.2	- 0.14
IRL	2 192.1	6.08	2 518.6	6.90	1 947.6	4.90	2 072.3	4.85	2 404.3	5.05	2 800.8	5.07
I	- 821.6	- 0.09	- 1 679.7	- 0.20	- 1 828.1	- 0.22	- 317.6	- 0.04	- 2 091.3	- 0.22	- 564.0	- 0.06
L	611.7	5.12	724.4	5.81	611.9	4.58	690.5	4.86	770.6	5.37	715.0	4.82
NL	66.8	0.03	- 261.7	- 0.10	- 468.2	- 0.17	- 684.5	- 0.23	- 1 428.1	- 0.46	- 1 224.0	- 0.38
A	-	-	-	-	-	-	- 883.5	- 0.50	- 351.6	- 0.20	- 873.9	- 0.48
P	2 162.7	2.98	2 513.8	3.52	1 953.1	2.64	2 542.2	3.21	2 806.6	3.36	2 675.4	3.07
FIN	-	-	-	-	-	-	- 116.0	- 0.12	37.1	0.04	1.4	0.00
S	-	-	-	-	-	-	- 754.1	- 0.44	- 668.9	- 0.35	- 1 195.0	- 0.62
UK	- 1 024.7	- 0.13	- 1 405.8	- 0.18	1 144.4	0.13	- 3 005.1	- 0.36	- 783.5	- 0.09	- 658.5	- 0.06
Total	**0.0**	---	**0.0**	---	**0.0**	---	**0.0**	---	**0.0**	---	**0.0**	---

1) Simplified calculation, see Annex 3, point 4.1.

Table 7

Size of the UK rebate

	Imbalance[1]		Correction		Imbalance less correction		Other factors[2]		Budgeted correction	
	(1)		(2)		(3) =(1) – (2)		(4)		(5) = (2) +(4)	
	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP	Mecus	% GNP
1985	2 847.0	0.50	1 879.0	0.33	968.0	0.17	-897.6	-0.16	981.4	0.16
1986	2 748.0	0.46	1 813.7	0.30	934.3	0.16	57.4	0.01	1 871.1	0.33
1987	3 310.1	0.50	2 194.7	0.33	1 115.4	0.17	-381.0	-0.06	1 813.7	0.30
1988	3 943.0	0.57	2 150.6	0.31	1 792.4	0.26	44.0	0.01	2 194.6	0.32
1989	4 272.3	0.57	2 516.6	0.34	1 755.7	0.24	-324.8	-0.04	2 191.8	0.29
1990	3 833.8	0.51	2 452.4	0.32	1 381.4	0.18	41.3	0.01	2 493.7	0.33
1991	4 331.1	0.54	2 787.0	0.34	1 544.1	0.19	773.5	0.10	3 560.5	0.44
1992	4 164.7	0.52	2 659.7	0.33	1 505.1	0.19	-86.4	-0.01	2 573.3	0.32
1993	4 706.6	0.59	2 940.3	0.37	1 766.3	0.22	219.7	0.03	3 160.0	0.39
1994	3 575.8	0.42	2 276.5	0.27	1 299.3	0.15	36.8	0.00	2 313.3	0.27
1995	4 686.3	0.55	3 079.1	0.36	1 607.2	0.19	-1 611.0	-0.19	1 468.1	0.17
1996	4 570.6	0.50	2 856.5	0.31	1 714.1	0.19	88.8	0.01	2 945.3	0.32
1997	3 442.7	0.30	1 977.5	0.17	1 465.2	0.13	481.3	0.04	2 458.8	0.22
1998	6 945.0	0.56	3 931.2	0.32	3 013.8	0.24	-700.6	-0.06	3 230.6	0.26

1) The imbalance is calculated as in the "Mode de Calcul", see Annex 4

2) Other factors include the adjustment for the definitive calculation of the year "n-4" and exchange rate effects(see Annex 4, page 3-4)

Table 8

Gross national product at current market prices per head of population

(until 1990: EUR-15 excluding East Germany = 100; from1991: EUR-15 including new Länder = 100; 1998-99: forecasts)

ECU

	1980	1982	1984	1986	1988	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
B	121.3	103.8	101.0	104.0	102.9	104.0	106.0	108.5	115.3	117.9	121.5	117.4	112.8	111.4	110.8
DK	126.1	124.6	131.1	139.7	134.9	127.8	124.3	125.7	132.8	134.7	140.2	138.8	137.4	137.6	138.8
D	131.9	126.5	129.9	132.4	129.2	127.3	114.6	119.7	127.1	127.8	130.9	124.9	118.6	116.6	116.1
GR	52.1	58.4	53.5	43.1	42.6	44.0	46.6	46.9	48.1	48.5	49.2	51.6	53.3	50.2	50.2
E	55.8	55.5	52.3	53.7	58.3	66.7	71.4	71.6	65.9	62.2	63.4	64.5	62.6	63.0	63.9
F	123.8	120.6	115.7	118.9	113.2	111.4	110.3	111.0	115.3	115.5	116.4	114.2	109.9	109.1	108.8
IRL	57.7	64.2	61.9	61.4	58.0	61.3	62.4	63.8	64.4	66.9	69.1	73.1	79.9	79.4	82.7
I	79.8	83.8	92.7	95.8	97.1	101.1	105.3	102.4	91.4	88.7	83.2	91.4	92.2	91.5	91.8
L	157.8	163.1	171.4	179.4	173.3	184.0	192.3	191.6	197.6	199.5	201.8	192.1	186.4	186.1	186.2
NL	120.9	115.8	112.0	111.1	102.9	100.7	101.2	102.1	109.4	110.7	113.7	111.7	108.1	108.0	108.4
A	103.1	106.1	109.3	111.7	109.5	109.2	111.8	114.5	122.5	123.8	127.6	124.0	118.8	117.6	117.3
P	28.5	29.9	26.2	29.6	31.5	35.8	41.5	46.4	45.7	45.3	46.8	47.0	46.7	46.8	47.6
FIN	105.6	122.1	130.1	126.1	136.1	139.5	123.3	98.2	85.3	93.7	105.9	103.6	104.9	105.1	106.1
S	149.9	142.1	144.5	140.9	139.8	137.8	142.4	134.3	110.4	110.9	111.7	118.4	114.2	114.3	115.0
UK	95.2	102.9	98.6	89.5	96.2	89.1	91.2	87.4	86.9	88.5	83.8	85.8	101.8	106.7	106.2
EUR-15	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

ANNEX 8

Table 9

Gross national product at current market prices per head of population

(until 1990: EUR-15 excluding East Germany = 100; from1991: EUR-15 including new Länder = 100; 1998-99: forecasts)

PPS

	1980	1982	1984	1986	1988	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
B	108.5	107.9	106.8	104.1	104.7	105.3	109.2	111.8	116.7	116.6	115.7	115.2	115.3	115.3	115.2
DK	102.9	103.7	106.7	109.6	104.6	100.6	102.4	100.5	107.0	108.5	110.8	111.6	112.5	112.7	112.9
D	117.8	116.4	119.0	118.2	116.1	117.8	107.3	109.6	109.1	110.6	110.4	110.5	109.4	109.1	108.8
GR	66.6	65.2	62.8	61.4	59.9	59.3	62.3	63.8	65.3	66.2	66.5	68.1	69.0	69.1	69.8
E	70.0	69.7	69.0	69.5	72.1	74.2	79.4	77.4	78.3	75.7	76.8	77.3	77.7	78.8	79.8
F	112.9	115.3	111.7	110.1	109.5	109.7	113.0	110.8	108.5	106.8	106.7	104.6	104.3	104.4	104.3
IRL	62.3	62.3	59.6	58.0	58.6	64.3	68.7	71.3	73.0	77.3	80.5	80.0	82.4	84.8	86.8
I	102.1	101.9	101.9	102.4	102.9	101.9	105.5	104.8	102.4	103.1	103.7	103.2	102.6	102.5	102.7
L	146.7	168.7	173.5	181.5	176.7	185.2	196.6	191.8	188.2	183.9	181.6	175.8	176.2	175.0	174.9
NL	105.1	102.3	102.7	102.7	98.4	101.3	102.3	101.8	104.0	104.6	106.8	105.6	106.0	106.3	106.2
A	104.9	106.5	106.1	105.2	103.5	105.8	108.8	109.0	112.3	112.0	111.1	113.1	112.6	112.5	112.4
P	53.6	53.1	49.4	52.3	55.7	58.9	64.5	65.6	68.7	70.3	70.0	68.9	69.6	70.5	71.2
FIN	94.9	98.3	99.1	99.1	101.3	99.9	91.1	84.0	87.5	87.8	93.6	93.2	96.4	98.4	99.4
S	110.9	110.3	111.8	111.0	109.1	104.5	102.4	96.7	95.5	95.5	97.3	95.2	93.7	93.8	93.8
UK	97.0	97.4	99.6	101.5	103.5	99.5	96.3	98.0	99.2	99.0	96.4	98.8	100.3	99.4	98.6
EUR-15	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Table 10

Gross National Product at current market prices
(Ecu-Euro millions; 1998-1999: forecasts)

	1992	1993	1994	1995	1996	1997	1998	1999
B	173 285	184 518	197 653	211 690	214 466	217 025	224 335	234 203
DK	103 348	109 322	116 203	126 018	131 339	137 032	143 815	152 454
D	1 533 230	1 636 447	1 725 209	1 837 598	1 839 972	1 837 908	1 892 649	1 976 634
GR	76 979	79 211	83 817	88 328	97 098	105 948	104 786	110 127
E	443 957	408 476	403 293	427 168	455 245	465 373	489 076	519 717
F	1 012 148	1 054 623	1 108 652	1 163 060	1 198 541	1 217 015	1 268 038	1 329 741
IRL	36 070	36 518	39 760	42 752	47 645	55 273	57 871	63 702
I	925 235	827 616	841 397	819 264	944 011	1 001 758	1 039 694	1 094 776
L	11 954	12 478	13 350	14 210	14 356	14 825	15 662	16 614
NL	246 411	265 427	282 152	302 185	311 923	318 548	334 421	353 054
A	144 027	155 310	164 805	176 503	179 687	181 492	188 199	197 137
P	72 485	71 422	73 913	79 271	83 476	87 098	91 326	97 217
FIN	78 691	68 572	79 062	93 011	95 509	101 827	106 880	113 306
S	185 075	152 696	161 400	169 937	189 562	192 439	201 625	212 725
UK	806 011	802 726	856 957	844 401	907 294	1 134 509	1 246 095	1 301 867
EUR-15	**5 848 906**	**5 865 362**	**6 147 623**	**6 395 397**	**6 710 125**	**7 068 070**	**7 404 472**	**7 773 274**

Table 11

Total population
(1000)

	1992	1993	1994	1995	1996	1997	1998	1999
B	10 045	10 085	10 116	10 137	10 157	10 182	10 208	10 233
DK	5 171	5 189	5 205	5 228	5 262	5 278	5 298	5 316
D	80 594	81 179	81 422	81 661	81 895	82 060	82 250	82 425
GR	10 322	10 380	10 426	10 454	10 465	10 518	10 570	10 623
E	39 008	39 086	39 150	39 210	39 270	39 323	39 371	39 371
F	57 374	57 654	57 900	58 138	58 375	58 607	58 877	59 148
IRL	3 555	3 574	3 586	3 601	3 626	3 661	3 696	3 730
I	56 859	57 049	57 204	57 301	57 403	57 506	57 609	57 714
L	392	398	404	410	416	421	426	432
NL	15 182	15 290	15 381	15 460	15 523	15 603	15 692	15 761
A	7 914	7 991	8 030	8 047	8 059	8 084	8 108	8 132
P	9 833	9 840	9 840	9 847	9 866	9 876	9 886	9 896
FIN	5 042	5 067	5 088	5 108	5 125	5 140	5 155	5 170
S	8 668	8 718	8 782	8 847	8 901	8 918	8 936	8 954
UK	58 006	58 191	58 395	58 606	58 782	58 977	59 172	59 367
EUR-15	**367 965**	**369 690**	**370 927**	**372 054**	**373 124**	**374 153**	**375 254**	**376 272**

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