THE POLITICAL ECONOMY OF FINANCING THE EU BUDGET

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Abstract

By adopting a more specific political economy perspective, this paper aims at contributing to the debate on reforming the actual system of funding the EU budget. We argue that the present debate is often ill focused and that what is really at stake is the nature of the European Union, whether this is just a club of sovereign states or a true federation directly affecting European citizens, who have then the right to be represented even on matters concerning the EU budget. We also argue that the main reason to reform the present system lies in the legitimacy crisis the EU is currently facing and that proposed reforms should be assessed on the basis of their ability to address this problem. Also, a dynamic perspective, asking how a budget reform would affect the bargaining positions of the different European institutions, is essential to understand the forces at play and to assess the possibility that a reform will take place.

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1. Introduction

Following the rejection of the Commission proposal in 2011 by the Council, the debate on how to reform the funding of the EU budget is once again on the table. Critics focus on the lack of transparency and political accountability of the present system, as well as on the distort incentives that the system offers to finance “pork barrel projects” of limited national interest, rather than true European “public goods” that might benefit European citizens at large. Indeed, there is now a large academic literature proposing normative criteria for a “true” European tax and discussing possible candidates on this grounds. A High Level Group, made up by experts and representatives of the Commission, the EU Parliament and the Council, has also been set up to analyze the problem with the aim to advance a proposal by mid-2016.

This paper reviews this debate, adopting a specific perspective, suggested by the literature on political economics. Thus, rather than asking which would be the “optimal” normative criteria for the setting up of an European tax, the paper tries to raise issues about the political economic reasons for a reform, enquiring on the agents that would benefit or being damaged by the reform, and which elements of a possible reform could find support across member states and public opinion. We also argue that the discussion should be set in a dynamic perspective; to understand the forces at play, one should ask how the funding reform might affect the bargaining position of the EU Parliament with respect to the Council in future negotiations, or more generally how would it change the relationship between the Union and member states.

Specifically, we argue that the debate about the funding of the EU budget is really a debate about the nature of the European Union, whether this is just a club of sovereign states or a true federation directly affecting European citizens, who have then the right to be represented even on matters concerning the EU budget. This nature remains presently unsettled both on legal grounds, with contrasting statements in the Treaties, and matter of fact, in terms of the actual functioning of the Union. If the former view is taken, perhaps no action should be started and what is perceived as defects of the EU budget can be conceptualized as the equilibrium result of a bargaining game with side payments, where lack of transparency and what apparently may look as “unfairness” in spending allocation may in reality play an important and useful role.

Things change if the second view is taken. In this case, criticisms are founded and the Union should move towards a more transparent funding system, largely based on taxes raised directly on citizens. In a political economics perspective, what determines which view should prevail depend more on the political forces at play than on legal or normative arguments. Among the European institutions, the pressure to reform comes mostly from the European Parliament, which however seems to be too weak to be able to bring about a serious reform. Decisive political support might instead come from (some or a subset of) member countries, as a reform of the budget might be a way to address the legitimacy crisis that the EU (and the EMU) is currently facing and to allow for focusing spending on policies of more interest for an European constituency. This has also implications on the type of funding reform one should envisage, as “cosmetic” changes are unlikely to be enough to address a legitimacy problem.
We also argue that in a dynamic framework, even a limited change in the source of funding for the EU budget would lead to a political dynamic strengthening the Union with respect to member states, eventually putting strains on some fundamental features of the present budget (such as the fact that the EU budget has always to be in equilibrium). Anticipations on this future political dynamics are probably the main reason why many member countries resist the change, while the EU Parliament is pressing for it.

Given what is really at stake in the debate, the issue of which are the “optimal” European taxes is of relative importance. Still, we argue for a basket of European taxes, rather than just one tax, and on taxes that at least apparently (that is, in terms of formal incidence) rely on more subjects to allow for a better balancing of the burden across different groups in the society and across member states. This would be important on political economic grounds, to increase the acceptability of the reform. Finally, we also believe than in a transitory period, GNI-countries contributions should be maintained, although reduced in size (to allow for compensation across countries), and that the Council should maintain the right to set a ceiling on maximal multi-annual expenditure. In a situation where democratic accountability at the European level is far from being properly established, this should limit the incentives for excessive tax and spending.

The rest of the paper is organized as follows. Section 2 describes the actual system of financing the EU budget. Section 3 discusses the limits of the present system, while Section 4 deals with the most recent proposals for reform. Section 5 is devoted to discuss the revenue side of the EU budget by adopting a specific political economy perspective. Section 6 concludes.

2. The present system of funding of the EU budget

The principle of financing the EU budget by means of own resources, already envisaged by the European Economic Community Rome Treaty of 1957 (art. 200 and art. 201), is laid down by the art. 311 of the amended Treaty on the Functioning of the European Union (TFEU): “without prejudice to other revenue, the budget shall be financed wholly from own resources”. In the fiscal federalism literature (Ambrosanio and Bordignon, 2007), a political body has “own resources” if these revenues are levied directly from taxpayers and accrue directly to the budget of the entity, without being determined by decisions taken by some other superior political bodies. Differently from “tax shares”, own resources are also usually accompanied by some autonomy (for instance, at least the possibility of varying the tax rate), although not necessarily by the right to impose the tax or to set up its characteristics. For instance, local governments around the world are typically partly financed by “own taxes” and they have at least the right to choose the tax rate within some interval, but the legal right to impose the tax lies in the central government who also defines the tax base.

The reason why the EU should be financed partly or fully by own taxes lies in its dual legitimacy, with respect not only to member states, but also to their citizens, a role that has been strengthened with the introduction of an elected European Parliament. Putting it differently, the EU legislation binds not only member states, but also their nationals, and this may provide an argument for having both democratic accountability and financing at the EU level.
However, the general principle of financial autonomy at the EU level is accompanied by a heavy legislative procedure that goes exactly in the opposite direction. This is based on unanimity by member countries and ratification by national parliaments for adopting the Own Resources Decision (ORD) by the Council, in order to respect the principle of national sovereignty in tax matters.

Regarding this decision, the European Parliament, that directly represents European citizens, plays only an advisory role. Moreover, art. 322(2) of the same TFEU says that the Council, after consulting the European Parliament and the Court of Auditors, regulates methods and procedures through which revenue from own resources are made available to the Commission.

The heavy limitations on the revenues side of the EU budget are accompanied by even sharper limitations on the expenditure side. More specifically: 1) the overall volume of EU revenue is limited by an own resources ceiling (currently, payments from the EU budget should not exceed 1.23% of the EU GNI); 2) the EU budget must be in equilibrium each year, with annual expenditure that determines the revenue accruing to the EU budget in the same year; 3) a multiannual financial framework (MFF) sets up the maximum annual amount of payments for broad categories of expenditure for a period of 5-7 years, with only marginal adjustments, allowed year by year, and a mid-term revision. In turn, as already stated, the MFF is adopted unanimously by the Council, following a proposal of the Commission. The European Parliament must give its consent, but it can only adopt or reject the MFF proposal, without deciding its contents. As a matter of fact, this means that expenditure out of the EU budget, as well as its distribution across member countries (up to over 90% of the budget, according to Cipriani, 2014), is predetermined by the MFF.

Against this scenario, the definition of “own resources” that is currently used for the EU budget has little to do with the notion of own resources as discussed in the fiscal federalism literature. More precisely, the current system includes in the EU “own resources”, traditional own resources (TOR), the VAT-based resources, the GNI-based resources, and several correction mechanisms for “budgetary imbalances” specifically devoted to net contributors Member States (see details below). Among these sources, only TOR (which include customs duties, agricultural duties, and sugar and isoglucose levies) can be thought of as “true” own source of financing, in the sense that they accrue automatically to the EU budget (net of a 25% flat-rate deduction to the member states collecting these revenues, as a form of refund for “collection costs”). The rest are in fact contributions from member states, based on some key value, such as each country’s GNI, that should represent a

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1 ORD No. 2007/436 of 23 June 2007. On 26 May 2014 the Council adopted the new ORD, the seventh one since 1970, but its ratification by each Member State probably will happen only at the beginning of 2016. According to this decision there will be a reduction in the amount of payment appropriations; in the rate of VAT-based resources for Germany, the Netherlands and Sweden; in the GNI-based resources for Denmark, the Netherlands, Sweden and Austria; and in the collection costs of traditional own resources (TOR) from 25 to 20%.

2 According to the Council Regulation n. 1311/2013 laying down the MFF 2014-2020, the compulsory mid-term review has to allow the institutions to upgrade the priorities, and to take into account the suddenly developed changes in the economic situation and in macroeconomic projections (art. 2). The annual technical adjustments to the MFF refer instead to recalculation of ceilings, overall figures, and margins (art. 6). Adjustments for cohesion policy envelopes (art. 7), and adjustments related to measures linking effectiveness of funds to sound economic governance (art. 8) are also envisaged.

3 Notice that the legal texts define all EU financing sources as own resources. A minor part of the EU budget is financed by other revenue (surplus from previous year) and miscellaneous revenue. With the exception of TOR, VAT and GNI-based own resources are provided to the EU budget by national Treasuries and they are more frequently recorded in the national budgets of member states as government expenditure rather than government revenue reduction.
measure of the relative contributive capacity (prosperity) of individual member states. Even the VAT-based resources have little to do with the VAT revenues as collected by member states. They come from the application of a call rate of 0.3% to the VAT theoretical harmonized tax base of each member state, which is further capped at 50% of each member country’s GNI.\(^6\) Besides, the “rebates” that are guaranteed to different member states are computed out of the VAT-based resources. Specifically, there is a permanent correction mechanism, introduced in 1984\(^7\) and then further revised, that reimburses to the UK up to 66% of its budgetary imbalance (i.e. the difference between the UK share in the EU total allocated expenditure and the UK share in the EU total VAT-based and GNI-based resources).\(^8\) Temporary rebates, in the form of reductions on GNI-based resource payments or reduced VAT call rates, refer also to Germany, the Netherlands, Sweden and Austria.

As shown in Figure 1, the evolution of the EU revenue system has seen relevant changes over the years, with an increasing role of GNI-based resource, originally introduced as a residual source of financing covering the difference between expenditure needs and the revenues generated by other sources. By now, the GNI-based resource has become the dominant source of revenue for the EU budget, covering more than 74% of total EU revenues in 2014. In contrast, in the same year, TOR accounted for 12% of total revenues and VAT-based resources for about 13%.

[Figure 1 near here]

3. The limits of the present system

The present funding system has both advantages and potential limits. The main advantage, as stressed by the first report by the High Level Group (2014), is that it works. Money flows regularly to the EU budget (although recently with some problems of delayed payments) and it is regularly spent on the agreed upon expenditure items. The actual spending is slightly below the ceiling of 1.23% of EU GNI (in fact it is close to 1.1% of EU GNI), but on the whole mandated expenditure is financed, and the EU budget is maintained in equilibrium both on an annual and multiannual basis.

However, the current system also presents several limits, increasingly stressed by the Commission and the European Parliament. In particular, according to the Court of Auditors, it lacks “simplicity, equity, transparency and democratic accountability”. Complexity refers to revenue collection, calculation, and control of contributions. The system of computing the VAT-based resources is utterly complex and open to several reservations, while the issues of statistical reliability and comparability of data on GNI for the different member states create problems in determining the GNI-based resources. This complexity gives room to “reservations” from the European Commission, concerning the reliability of the data supplied by the member states and therefore the

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\(^6\) This capping was introduced in 1988 in order to take into account the fact that the VAT base tends to be relatively broader in poorer member states.

\(^7\) The 1984 Fontainebleau European Council fixed the principles of the existing correction mechanisms. The UK correction was introduced in 1985 because of the unique situation of the country arising from its low prosperity and its high contribution to the financing of the Community.

\(^8\) Operating budgetary balances are a limited and misleading way to measure the wealth and benefits that member states get from the EU budget. This issue will be further discussed in Section 3.
accuracy of their relative payments. At the end of 2013, there were 288 reservations awaiting solutions for the GNI-based resources and 108 reservations concerning the VAT-based resources (Cipriani, 2014).

Equity is a complex notion to establish, as is not obvious whether it should refer to citizens or member states and/or whether it should also take into account the expenditure side of the budget. Moreover, every quantitative indicator raises problems of reliability, particularly in an international contest and this makes any assessment even more complicated. However, the present system is generally thought of being “unfair” because the final allocation of the burden to pay to the EU violates a notion of “horizontal equity” across member countries, as the final payments show a large variance both with respect to member states GDP per capita and in percentage of their GNI (see Cipriani, 2014; Fuest et al., 2015), largely as a result of the different national “rebates”. In particular, in some cases, poorer countries pay to the EU budget more than richer ones. As an illustration of the argument, figure 2 reports the detailed computations made by Cipriani (2014) on member states’ contributions.

Being so complex, the system is obviously not transparent and it does not allow for democratic control by European citizens. For instance, a number of surveys show that the large majority of European citizens are unaware both of the size of the European budget and of the way in which the EU money is spent (see for instance, TSN Opinion & Social, 2011).

But, according to several critics (see for example, HLG, 2014; Cipriani, 2014; Le Cacheux, 2007), this is just the tip of the iceberg concerning the difficulties of the present funding system. The main problem is that by being de facto based on national contributions, the present funding system focusses all political attention in the determination of the budget on the “operating budgetary balances” of the different member states, that is on the difference between their “national contributions” to the EU (VAT and GNI-based resources) and their share in the “operating expenditure”. Figure 3 shows the operating budgetary balances for 2013.

As widely recognized, “budgetary balances” are just an accounting exercise provided by the Commission, questionable even as an exercise according to the Commission itself (as is based on “highly arbitrary conventions”). Budgetary balances do not measure the real benefits accruing to countries for their participation to the Union (the consumption of European “public goods”), not even in the strict sense of the benefits deriving from the EU expenditure, as spillover effects across countries are not computed in the exercise (see Cipriani, 2014: p.14). Still, budgetary balances (as well as national rebates) have become the central reference for the bargaining across countries for the determination of the MFF, with each country trying to get even in terms of resources given and received, asking for more expenditure allocated to its territory or for “rebates” from contributions if the budgetary balances are too negative. Budgetary balances are in addition the part of the EU

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9 Although one should remember the problems of reliability and comparability of the GNI indicators that make difficult to evaluate and give a normative meanings to variations from the standard.
budget that is subject to more scrutiny by the (national) media, adding pressures on national politicians to show that they “won” at the bargaining table and “brought the bacon back home”.

The negative feature of this process, according to critics, is that it distorts EU expenditure away from financing true European “public goods” (goods and services that offer benefits to European citizens at large), that are then under provided, with respect to “pork-barrel projects” of limited interest for European citizens at large. Indeed, as argued by several authors (see for instance Alesina et al. 2005), it would be hard to defend the actual pattern of EU expenditure, with reference to both the targets that the EU sets for itself (like the well-known statement of “becoming the most innovative economy of the world” in the Lisbon agenda, while still 40% of the budget is spent on Agriculture) and the policy priorities and preferences as expressed by the European citizens (TSN Opinion & Social, 2011). As an example, the relevant differences between Europeans’ perceptions and their expectations regarding the EU budget are shown in Figure 4.

![Figure 4 near here]

### 4. Proposals for reform

A large debate on possible reforms of the present funding system has emerged both among scholars (see Iara, 2015 for a recent survey) and the European institutions themselves. In particular, from 2004 on, different reform proposals have been put forwards by the Parliament and the Commission, although all without success. Specifically, in 2011, the Commission proposal, that was part of the 2014-2020 MFF, consisted in:

(i) the abolition of the VAT-based own resource;
(ii) the introduction of two new own resources from 1 January 2018: a financial transaction tax (FTT) and a new VAT-based resource which should provide the most important revenue share for the EU budget by 2020. The introduction of the FTT would aim at ensuring the (fair and substantial) contribution of the (under-taxed) financial sector to cover the costs of the crisis; discouraging inefficient and excessively risky financial transactions; and coordinating the otherwise fragmented internal financial market.

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10 See for instance the example of the drinking water reservoir in Brandenburg, co-financed by the EU, in Fuest et al. (2015). Did really Germany need EU money to finance a water reservoir?

11 In 2010, in its Communication on the EU Budget Review, the European Commission listed six possible candidates for the own resources system. A part from a EU taxation of the financial sector and a EU VAT, this non-exhaustive list also included: EU revenues from auctioning under the greenhouse gas Emissions Trading System (ETS), in line with the polluter-pays principle stated by the art. 191 of the Treaty of Lisbon; EU charge related to air transport which could take the shape of either a departure tax on passengers or a flight duty on passengers and freights transport; EU energy tax which could be placed side by side to the resources coming from the auctioning of emission allowances in order to better face the problem of CO2 emissions; and EU corporate tax facing the challenge of imposing a harmonized tax base to all firms (EU Commission, 2010).

12 The legal basis for the FTT is the art. 113 of the TFEU: “The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonization is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition”.

13 After the financial crisis, some member states, not only those that further signed the ECA (see below), introduced different taxes and levies on financial sector which increased the risks of relocation of financial activities and of double
VAT-based resource, the proposal would apply a single EU rate (max 2%) on the VAT tax base referred to the standard VAT rate in each member state. The introduction of this new own resource could also help to improve the general performance of the VAT system in terms of broadening the tax base, reducing tax evasion, and improving tax administration; (iii) the introduction of lump sum reductions in the GNI-based resource payments to replace all the existing correction mechanisms in case of excessive burden compared to the relative prosperity of a country;¹⁴ (iv) the reduction of the TOR collection costs retained by member states, often envisaged as a hidden correction mechanism, from the actual (unreasonably high) level of 25% to a more realistic 10%, i.e. the percentage of collection costs in place until 2000.

The proposal also contains some revisions concerning the ORD which should make it more transparent and easier to understand not only by the parliaments of the member states but also by EU citizens. According to the Commission estimates (European Commission, 2011b), with a EU budget of about €163 billion, in 2020 the two new own resources would account for €66.3 billion and then would finance 40.8% of the EU budget.¹⁵ The remaining 59.2 % would be financed by GNI-based resources (40.3%) and by TOR (18.9%).

However, the proposed abolition of the actual VAT-based own resource did not find the support of all member states. Critical issues were also raised against the new VAT: it had to be levied on member states and not on citizens with no improvement in citizens’ awareness; and the average share of VAT revenue from a EU common basket of goods and services taxed at the standard rate would not have been so easy to calculate due to the different sources and statistical methods across member states.

At the same time, the idea of a FTT at the EU level, with a high risk of relocation due to the fact that it was not internationally coordinated and some potential negative effects on economic growth and employment, was opposed by several member states. Following the request of eleven member states (Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain), the EU Commission proposed a Council Decision on an Enhanced Cooperation Agreement (ECA) in the area of FTT, that had to be based on the same aims of the original proposal of 2011.¹⁶

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¹⁴ The lump sum reductions amounted to € 3600 million for the UK; €2500 million for Germany; €1050 million for the Netherlands; € 350 million for Sweden. They should be better than the alternative system, i.e. the generalized correction mechanism (GCM), in different respects: fairness, simplicity and transparency, efficiency (incentives to implement EU programs) and the possibility to be limited in its duration (see European Commission, 2011d).

¹⁵ According to the initial EU estimates, FTT revenues could amount to € 57 billion per year in the whole EU (EU Commission, 2011c). Even though a high degree of uncertainty, further estimates indicate that revenues from FTT could go from € 30 billion to €50 billion per year for the EU-27 by 2020 if the tax should be applied not only to bonds, stocks and derivatives, but also to currency transactions. Concerning the new VAT, a 1% rate could raise revenue from € 20.9 billion to € 50.4 billion depending on the degree of harmonization of VAT systems (EU Commission, 2011d).

¹⁶ The revenue collected in this case, with respect to the original FTT proposal, should account for € 34-38 billion per year, that is 0.4% of the GDP referred to EU11. It has been claimed that the original FTT proposal could be amended with respect to three different points: exempting some financial instruments and some actors, and integrating the residence principle with aspects of the issuance principle. The EU11 FTT revenue should decrease to €30-34 billion if specific products (i.e. UCITS and AIF) are exempted (European Commission, 2013b).
After having surveyed the 2011 proposal, in February 2013 the European Council encouraged both the Commission to further work on the new VAT-based resource idea and the member states involved into the ECA to investigate the way in which the FTT could really become a new own resource for the EU budget. In November 2013 the European Parliament, the European Council and the European Commission established the High Level Group on Own Resources (HLG from now on) with the specific aim to go on with reflections on reforming the own resources system.

In December 2014, the HLG presented its first report. Besides summarizing the evolution of the EU funding and discussing the proposals advanced to date to reform the financing side of the budget, the HLG sets up a series of criteria that the taxes devolved to the EU budget should satisfy in order to be considered as a proper source of financing for the EU. These criteria are not very different from those advanced and already discussed by a large literature (e.g. Begg, 2011; Le Cacheux, 2007; Cipriani, 2014). Some of them are desirable features of any tax system (equity/fairness, efficiency, stability and sufficiency, transparency and simplicity, democratic accountability and budgetary discipline), others are more specific to the EU system (focus on European added value—e.g. the benefit principle, respect the subsidiarity principles, limit political transaction costs).

As an exercise, one can always contrast the desiderata of a “EU tax” with respect to the various candidates proposed in the literature, and see how the different proposed taxes fare with respect to these criteria. Indeed, several exercises of this kind have already been made in the literature (see for instance the summary in Iara, 2015).

5. A political economy approach to reforming the revenue side of the EU budget

5.1 On the political economy advantages of the present system

Section 3 makes it clear that the present system of funding the EU budget, despite some advantages, suffers from many potential problems. Summing up, there is a wide consensus in the literature that the present system is: 1) opaque; 2) utterly complex; 3) it does not allow for citizen’s political accountability; 4) it is “unfair” in its distribution across countries; and 5) it is in clear contrast with the spirit of the Treaty because national contributions de facto dominate “true” own taxes.

However, before rushing to argue for a reform, one should ask with respect to which normative standards these features should be considered as negative. This in turn depends on the view about the nature of the EU: a true federation, with a sovereignty of its own which transcends that of the member states; or just a club of sovereign states, which join forces in providing some common goods (say, participation to the common market) and also bargain on some payments as a side issue (the EU budget). The answer is not obvious. From a political economy perspective, what really matters in order to clarify the political role of the EU is not the legal status of the EU per se, but its actual interpretation and implementation, and the way in which it evolved through history and politics.

On these grounds, the EU institutional structure clearly shows contradictory elements, the results of several compromises, that in turn testify of the difficulty of building a supranational structure in Europe. So the EU has an elected European Parliament, representing European peoples, but
differently from any other Parliament, the EU one has not the right to decide about the size of the budget or how to allocate expenditure, except for marginal annual variations on a predetermined long term budget (Hix et al., 2006). The EU Parliament cannot even propose new legislation, because this is a prerogative of the Commission. There is “representation” but not “taxation”.

In contrast, legislation about a set of devolved functions (basically, the ones related to the common market) is decided according to a three tiers structure that closely resembles that of a bi-cameral federal state (with an executive, the Commission, appointed by the Council, but partly accountable to the Parliament, and two legislative chambers, one representing member states, the Council, and the other one representing citizens, the Parliament, who co-decide the policies), the so-called “supranational or communitary method”. Besides, strong regulatory powers have been exclusively assigned to the Commission, given its nature of guardian of the Treaty (defending the common market).

On the other hand, all decisions concerning resources, fiscal policies or other politically sensitive policy issues (such as foreign policy or defense) are taken up by member countries that decide according to the unanimity rule (Fabbrini, 2014a and 2015), the so-called “intergovernmental method”. The Lisbon Treaty strengthened this role of member states by institutionalizing the European Council (that now even appoints a President), which has become a second, and even more important, executive government of the Union.

Depending on the view that one has about the nature of the EU, the normative judgments about the financing of the EU budget are bound to differ. In particular, if one thinks to the EU as just a club of sovereign states, it is not difficult to provide arguments in support to points from 1) to 5) above, arguing *au contraire* that these are the features that one would expect, and perhaps also the ones that one would wish for, for the funding of the EU budget.

For instance, neither opacity nor complexity (and complexity is functional to get opacity) are a real issue, and indeed they actually may play a very important role from a political economy view (Dorussen and Nanou, 2006). Opacity allows each country leader to get back home and say “we won” in the intergovernmental bargaining, so saving face, even if the result was in fact negative for her/his country.

Lack of citizen’s accountability is also not an issue, as money belongs to member state governments, not to citizens. Finally, “unfairness” across member states is also not an issue; it is the potential result of a bargaining game across countries with side payments where some countries might have got more in some periods and less in others, to accommodate changing bargaining powers.

Indeed, what is perceived as “unfairness” might well be the *equilibrium result* of the need to compensate some countries, through rebates or increased budget expenditures, for having accepted some changes in legislature, even in fields not formerly covered by the budget. The EU is mostly a legislative body and most EU policies are pursued by drafting legislation that is later on adopted by member states. EU expenditure plays traditionally a minor role, not least because of the small dimension of the EU budget. It is therefore not unthinkable that the apparent unfairness in budget
financing (and expenditure) might be just the result of a compensating mechanism, to persuade some countries to accept modifications in other parts of the legislature. So “unfairness” may actually be not only useful, but indeed necessary.

There is some evidence in the political economy literature that supports this “bargaining view” of the EU budget. For instance, Kauppi and Widgren (2004, 2007, 2009) use different “power indexes” derived from cooperative game theory (Shapley-Shubik value, Banzhaf index etc.) to measure the bargaining power of each member country in the Council in different periods (depending on the number of countries and on the distribution of voting rights, that has changed along the time with the different revisions of the Treaties) and use these indexes as explanatory variables in regressions aimed at predicting the allocation of the European budget expenditure. They find that power indexes typically over perform other indicators (such as “needs” indicators), as explanatory variables. Interestingly, in analyzing the period before the Lisbon Treaty, Kauppi and Widgren (2009) also distinguish between “compulsory” and “not compulsory” expenditure (a distinction existing before the Lisbon Treaty), on the basis of the different role played by the EU Parliament in determining these expenditure (more limited on the larger “compulsory” component). They find evidence that in the “compulsory” part power indexes perform better than in the “not compulsory” part, while the opposite is true for “needs indicators”. Given the greater importance of the EU Parliament in determining the “not compulsory” expenditure, this supports the idea that the EU Parliament tends to divide itself more along policy lines rather than country lines, a point already raised in the literature on the EU Parliament (see Hix et al., 2006). We will come back to this in the next paragraph.

More generally, one could even argue that “distorting” the budget might have allowed to make substantial progress in the supply of “true” European public goods. The distortion of EU budget expenditure in favor of agriculture (an original French request), or the UK rebate are probably the clearest examples. On normative grounds, they both probably did not make much sense, but they kept both France and the UK on board, so allowing the Union to make progresses on other grounds.

Investments in “true” European public goods are probably sub-optimal, because the present system incentivizes too much the “just return” behavior. However it is an open question whether without this “inefficient” EU budget funding system, the progress that has been made even on more European wide public goods would have been possible at all.

A corollary of this argument is that making the system more transparent, still maintaining the present format of a EU budget financed by country contributions --for instance, by abolishing VAT-base resources and making everything paid in terms of GNI, and transforming the various “rebates” in lump sum deductions, as in the 2011 Commission’s proposal--, might not be a very good idea. It would not solve the problem of political accountability by citizens, while making the distributive conflict across member countries harsher.

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17 Baldwin et al. (2001) make a similar point for the distribution of expenditure in the years preceding the introduction of the Nice Treaty.
5.2. So why change?

Among the main European institutions, the only one that is really pressing for change is the European Parliament; the Commission just follows. This is quite easy to understand: leaving aside legal disputes, there is an obvious contradiction between the status of the European Parliament and its limited powers on the EU budget. As we argue below, the European Parliament would likely be the main winner of any reform of the EU budget involving increased own resources. However, it is unlikely that the Parliament alone could be the decisive agent for change, given its limited powers, and also given its limited political legitimacy with respect to national governments. Indeed, as we saw above, the proposal of the Commission in 2011, supported by the European Parliament, was rejected by the Council.

The real question on political economy grounds is whether the present system, that has served the Union pretty well in the past, is still sustainable. This is of course up for debate, but there are several signals that point to a negative answer. For instance, surveys show that citizens’ support for the Union has been reducing in the last years. As an example, figure 5 shows that by now only 40% of European citizens say that they trust the European Union, while they were 50% just 10 years ago (although the last Eurobarometer survey (May 2015) shows again some improvements). As a further example, figure 6 displays the increasing number of seats in the European Parliament allocated to Euro-skeptical parties.

If this were not enough, one should add the UK’s decision of reconsidering its position in the EU, leading to a referendum that might lead the country to secede from the Union (a Brexit), and the come to power in several EU member countries of political parties that have an explicit anti-EU ideological platforms (e.g. Poland, Hungary, Greece). The criticisms raised against the Union from all these different movements and political parties are almost the same: lack of legitimacy of the European institutions, technocratic bodies that do not respond to citizens’ preferences, little value for money in EU spending, inability to face citizens’ true economic problems and so on (“populism” in Acemoglu et al., 2013).

It is then hard to escape the conclusion that the EU is facing a legitimacy problem and that it needs to find ways to overcome the distance that has emerged between EU institutions and EU citizens. Concerning the debate on the EU budget, this of course could go both ways.

Given the current low level of consensus for the EU institutions, revising the EU budget funding system in the direction of increasing own financing, making it more transparent to citizens and also giving more power to the EU Parliament on the determination of the budget, may be a very risky move, even threatening the survival of the Union or the maintained participation to the Union of all present member states.

On the other hand, it is hard to think of any better move to start regaining legitimacy among European citizens than giving them a more direct say through their representatives in the EU
Parliament on how money is raised and spent at the European level. Countries and country leaders are conscious of this legitimacy crisis, and perhaps this might provide the political push needed to support a reform of the budget, above and beyond legal prescriptions or the pressures coming from the European Parliament.

5.3 Which change?

The above argument has several corollaries.

First, if the main reason to reform the budget is a legitimacy crisis, middle grounds solutions are unlikely to solve the problem. For instance, the 2011 Commission proposal, had it been accepted, would not have addressed sufficiently the accountability problem. As already discussed, the new proposed VAT would have been levied on member states not on citizens, and therefore would not have been visible to them.\footnote{Notice that this proposal in itself is a retreat from a Commission proposal advanced in 2004 and confirmed in 2010, which aimed at introducing a VAT-based resources through a EU VAT tax rate, incorporated and levied together with the national rate and so on the same taxable base.} If the point is to make citizens more aware of EU costs and expenditure and EU institutions more accountable to them, it is difficult to escape the conclusions that a reform of the EU budget would require some type of EU tax, paid directly from citizens to the EU budget.

The second observation is that given the present situation, it looks unlikely that all countries would accept a more fully fledged move towards own financing through a EU tax. It is hard to see any substantial proposal that in the present context would find the unanimous consensus of all member countries. Thus, if one insists on having the proposal approved by unanimity, the most likely result is that the status quo will prevail, in spite of the widespread consensus, even among many member states, that the present system is outdated and unable to answer citizens’ demands.

The conclusion is that a bolder mode towards own tax financing for the EU budget could and should be probably adopted by only a subset of countries. Clearly, this could not happen with a new tax, because the other countries might object (as indeed happened with the FTT, which is then going to be adopted, if ever, through an enhanced cooperation agreement). However, there is nothing that could forbid a subset of EU countries to pool together some existing tax resource (say, a fraction of VAT), and use it to finance their share of the EU budget, if they wish to do so.

The Euro countries, or more generally the EU countries who have either adopted, or that are thinking to adopt the Euro in the future, are the obvious candidates to form this subset.

5.4 A EMU budget?

There is a quite large consensus that the EU countries need to integrate more on the economic side, and that adopting some mechanisms to share risks and supporting more growth friendly policies may be necessary if the monetary union is going to survive. The dismal performance of many EMU countries in the recent international crisis, as compared to United States or the UK, suggests that the macroeconomic governance of the area has been suboptimal (see for a recent discussion, Blanchard...
et al., 2015). This dismal outcome is also probably one of the reasons behind the increased citizens’ discontent in several countries. Conceptually, a EMU budget could be part of the solution as it might provide resources to support more growth friendly policies.

Indeed there is an increasing literature, not only purely academic, that openly talks about the need of introducing a “EMU budget”. The two “Reports of the Presidents” (Van Rompuy et al., 2012; Juncker et al., 2015), written by the highest authorities of the EU, explicitly underline the need of a “fiscal union” that together with the “banking union” and the “capital union” should accompany in the future the functioning of the “monetary union”. “Fiscal union” might of course mean several things, but one plausible interpretation, certainly in the academic literature, is the EMU budget (see for instance, Benassy et al., 2014; Baglioni, et al., 2015; Trannoys and Wolf, 2014; Fuest et al. 2015). On these grounds, it is tellingly that the countries that have decided to go on with an Enhanced Cooperation Agreement on the FTT are mostly EMU countries.

Such a change could perhaps be accommodated in the present EU institutional framework in the short run,19 but it is hard to think that it could be sustainable in the long run. A EMU budget would further add to the dynamics of “internal secession” of the EMU countries inside the EU (Fabbrini, 2015) and sooner or later an institutional change (such as a revision of the Treaty) would become necessary. On the other hand, pending the UK referendum, such a revision of the Treaty might be unavoidable anyhow. Different European countries have different views about the nature and the future of the EU, and the rhetoric of a common destiny which admits only temporary deviations is getting more and more inadequate to represent this reality (Bordignon and Brusco, 2007).

Furthermore, a EMU budget would probably need to be larger than the 1% of GNI envisaged in the present EU budget and cover different policies to be of use. A future equilibrium institutional structure would then be based on two “budgets”, inside the larger EU budget, one for the policies supported commonly by all countries, and another (larger) one only for the EMU countries to support policies specific to the common currency area.20

5.5 Political dynamics of EU taxes

As discussed in Section 3, the debate on own EU financing is mainly focused on drawing up a list of criteria that the “optimal” European financing scheme should satisfy. On a normative perspective, this is of course a desirable way to proceed. However, from a political economy point of view, this discussion seems of secondary importance. First, because there is no tax that meets all principles at once, as largely acknowledged by the literature, and trade-offs are necessary. Second, because the true question about financing is how this is going to change the relationship between the Union and the member states, or more specifically between the EU Parliament and the Council.

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19 Begg (2011) for instance proposes a system where some countries, say the EMU countries, pool resources for the EU budget through a common tax, while the others keep their contributions unchanged.

20 The EMU budget should remain inside the EU structure, so as to maintain scrutiny by the European Parliament. But which Parliament? The answer is again not obvious, but it stands to reason that on EMU policies only legislators belonging to EMU countries should have the right to vote. Indeed, the German Minister of Finance has already advocated such a move.
Political economics is mostly about distribution; who wins and who loses from the different proposals in terms of both power and resources. A move towards a new financing of the EU budget based on own resources would affect this balance across at least three different levels:

a) the relationship between different groups in society (e.g. producers versus consumers, poor versus rich people, agriculture versus services, and so on);

b) the relationship between member states (who is going to win or lose with respect to the actual distribution in terms of resources);

c) the relationship between the Union and the member states, that is, to simplify, between the EU Parliament and the Council.

The specific characteristics of the tax eventually chosen are surely going to be important in determining a) and b). However, in the current situation, the most relevant relationship appears to be the last one listed above. Reforming the EU budget, so that it is fully or largely financed out of own taxes, paid directly by citizens, rather than national contributions, is not a marginal change; and even if the change was marginal at the beginning, it would certainly start a political dynamics that might eventually lead to permanent changes in the relationships between the Union and the member countries.21

Let us illustrate this dynamics with a simple example. Suppose, following Cipriani (2014), that a EU-VAT at 2% is introduced (with an offsetting variation in the national rate, in order not to increase the tax burden for each consumer) on the subset of goods and services that in all EU member states are taxed at the standard rate, thus avoiding redistributive effects across countries. National contributions are then set up to keep the total contribution of each member state (the new EU-VAT plus GNI-based resources) unchanged. And finally suppose that all the rest of the system remains unaffected, including the MFF decisions about EU spending and all other spending decision rules. What would be the difference with respect to the present situation? Apparently none, expect for the fact that voters/consumers would now be more conscious of how much they pay to the EU if the 2% EU-VAT rate was clearly indicated in their VAT receipts (this is Cipriani’s proposal).

But this would create a difference in future negotiations. The EU Parliament, having established the principle that the EU is, and ought to be, financed with own tax resources, would naturally start to ask for more power on this tax base, according to the corner principle of Western democracies that links representation and taxation. To begin with, more power to set the European tax rate, to finance European services.

Furthermore, the fact that the main source of revenue for the EU budget is now a tax, instead of national contributions, would naturally lead to questioning the idea that the EU budget must always be in equilibrium. If EU tax revenue falls, because of a downturn, why EU expenditure should remain unchanged? There are of course technical ways to insure a stability of EU expenditure, but how could one argue that a tax financed expenditure at the EU level should be stable, while member countries expenditure should not? But then, if the EU budget must not be necessarily in equilibrium,

21 The relevant scientific literature discusses these phenomena under the general heading of “evolving federations”. For examples, see for instance, Bordignon and Brusco (2001, 2007), Alesina et al. (2005), and the collection of essays in Wildasin (2010). See also Cipriani (2014).
why the EU should not borrow money in some periods, say during a downturn, and use tax revenues as collateral? EU bonds issuance and EU debt would become an obvious chance.

Finally, if EU tax financing is made more transparent, citizens might then feel more entitled to ask how their money is spent. Would this be compatible with the actual multiannual financial framework that leads member countries to decide not only how much, but also how and where EU money is going to be spent, so largely constraining the choices of the present EU parliament by decisions taken five or seven years before? This seems very unlikely. On the contrary, the EU Parliament would start asking for more power on the expenditure side, both on the annual and multiannual framework. More autonomy on the spending side would capture more attention of European media and probably lead to an increased polarization of the European Parliament on policy lines. This, in turn, would probably require some institutional changes to keep the system running (for instance the direct election of the President, see the discussion in Hix, 2008). And so on.

Clearly, this process would take time and might not at all be linear or incremental. History suggests that central governments in federations acquire (or lose) powers in reactions to crises, not in a smooth way or because it is prescribed in the Constitution (see for instance, Bordo et al., 2012 for a history of the US federation, and Rodden et al., 2003 for examples about other federations). But the introduction of a true EU tax would ignite the process, with consequences that are foreseeable, although timing may be not. This future political dynamics is probably clear to all actors involved; and this is quite likely the reason why the EU Parliament is pressing for a change in the budget funding, while many member countries resist this change. What is at stake, it is the balance of power between the two bodies, or more precisely between the Union and its members.

Finally, one might ask whether introducing an EU tax is really necessary to start this dynamic. Perhaps, the same result could be achieved by letting the present funding system remain unchanged (that is, basically financed with member country contributions) and just by giving more power in the determination of spending allocations to the European Parliament. Member countries would still try to affect the distribution of the budget, of course, but as discussed above, there is already some empirical evidence proving that where the EU Parliament has a larger say on spending allocation, outcomes are different and are less affected by the bargaining power of member countries. Wouldn’t this be enough?

Possibly, but there are two serious counter-arguments to this view. First, it is very difficult to image that member countries would be willing to give up their sovereignty on “their” money to another entity such as the EU. As long as is “their” money, about which national governments are directly accountable to their nationals, member countries would (rightly) demand for a strict control on how it is spent. Some compromise could be struck of course, but certainly member countries would ask to retain most of their power in determining expenditure.

The story would be completely different is instead it was the “money” of the European “federation”, assigned directly to the Union by giving up some tax base or portion of tax base of the member countries. The political logic would be entirely different. If it is the money of the Union, it is the latter job to decide how to allocate it, through its democratic institutions (the interplay of the
Parliament, the Council, the Commission through the *communitary* method) and are these institutions that would become jointly responsible for its use in front of the European constituency.

Second, the main advantage of a EU tax, the greater visibility for citizens with its implied effect in terms of increased accountability, would be completely lost if the money kept arriving by the member countries’ treasuries. An important piece of the political dynamic discussed above would then be missing.

Finally, one might wonder if the issue of EU tax is also linked to the size of the budget. Shouldn’t one need a larger EU budget to advocate for an EU tax? Does the EU really need to introduce a EU tax to finance expenditure for 1% of GDP? But this argument misses the main point of the discussion. The issue of how much money should be allocated to the EU budget and the issue of how it should be financed are conceptually separated problems. There might be arguments in favor of allocating more functions at the European level (or at least for a subset of EU countries in the several speed Europe that is emerging), but they should be discussed separately from the issue of how to finance them. It is an easy bet to predict that had the 1% of EU GDI accruing to the EU budget being financed differently, through EU taxes, it would also have been spent differently.

### 5.6 On the implementation of an EU tax

Assuming a move towards the financing of the EU budget with own resources, the question then becomes which kind of taxes and how many. On one hand, a single tax would have the advantage of making it clearer to citizens where the money is drawn and to some extent who pays for it. On the other hand, a multiple taxes system would have the advantage to cover potentially more subjects, thus allowing to redistribute the burden more evenly across different groups of the society, that might also have a different distribution across member states, thus limiting distributive conflicts.

In discussing this point, it must be realized that from a political economic point of view the *apparent* distribution of the tax burden is at least as important as the *real* one. Tax incidence is a cornerstone of economic analysis, and it is well know that the true payers of a tax might be very different from the agents formally subject to that tax. For instance, economic literature would suggest that corporate income taxation is borne by workers and consumers, in a proportion that depends on market conditions (the standard reference is Auerbach, 2006; see Fuest et al., 2013 for a recent analysis). Still, in citizens’ perception a tax on banks or companies is a tax on these subjects and it is very hard to convince them otherwise.

Then the general suggestion is that it might be more advisable, to avoid conflicts and make the change more acceptable, to consider a (limited) basket of EU taxes, that gave at least the impression of a widespread distribution of the burden, rather than focusing on a single tax. Especially at the outset, it would be important that no member country (or subset of member countries) loses from accepting the reform of the financing of the EU budget. In fact, even if this loss could always be accommodated ex post by reducing national contributions, it would be better to reach this goal ex ante with a balanced set of taxes. Finally, a restricted basket of EU taxes might also make revenues more stable to economic cycles.
As argued above, there is already a large literature discussing pro and cons of the different possible EU taxes, using different sets of normative criteria. Without going into details, some considerations are in order, again from a political economy perspective.

First, many proposed taxes (e.g. various forms of energy taxes, carbon taxes, air transport taxes) reflect a “polluter pays” principle. Even the rationale for the FTT proposed by the Commission referred to the same principle, as the FTT was supposed to reduce high frequency speculative transactions of financial activities. However, this kind of taxes seems to be unfit to finance the EU budget, for several reasons. First, if they work, they do so precisely by reducing their tax base and therefore are by definition unfit to regularly finance a budget. In some cases, tax elasticity are known and can be computed, because these taxes already exist; in others, such as in the case of the proposed FTT, tax elasticity are not known and can only be vaguely guessed from other experiences. So, in spite of the political advantage of introducing a new tax on a tax base that does not clearly belong to any country (nobody can complain of losing revenues), the FTT amounts to a particular implausible tax to found the EU budget autonomy.

Second, Pigouvian taxes are more adapted to be earmarked to some specific kind of expenditure, rather than to finance a general budget. In other words, they can be proposed to support EU policies in some specific areas (assuming that these policies need financing and are not just regulatory policy) and not to become a constant source of revenue for the EU budget.

The same is true for the hypothesis of introducing a specific banking tax (similarly to the Financial Activity Tax proposed by the IMF in 2010) which would replace all the existing taxes on banks, and using part of its revenues to finance first the “fiscal backstop” for the resolution mechanism in the new EMU banking Union, and then the general budget (Bénassy-Quéré et al., 2014). These taxes are good to finance a specific activity and can become part of a EMU budget together with other sources of revenue, but certainly they are not the right resources for funding a EU budget, as many EU countries do not have agreed to the banking union and related supervisory mechanism.

Many proposals have stressed the importance on normative grounds that EU own resources adhere to the “benefit principle”; EU taxes should be related to some functions explicitly conducted by the Union. This is even more important on political economy grounds because it might increase the acceptability of the EU tax across citizens.

Thus, for instance, VAT is a robust candidate on these grounds, because one could easily argue that consumption captures the advantages that consumers get from the unique European market. Moreover, VAT is already largely harmonized at the EU level and, if adopted with some modifications, a EU VAT might also allow to fight frauds and tax evasion, induced by the incomplete shift to the origin principle in the EU model. Further, VAT has a large tax base and even a small EU rate (say, 2%) would generate a large revenue, covering a substantial part of the EU budget. A true EU VAT rate, restricted to the subset of goods that are taxed at the standard rate in all countries, with offsetting reduction in the national rate, could then be introduced and made clearly visible to citizens by indicating the EU rate in the VAT receipts (see the detailed proposal in Cipriani, 2014).
One problem with this proposal is that the bundle of goods and services subject to the standard rate is not the same in all countries, and as we discussed already in section 3, there are substantial differences in implementation and monitoring of the VAT across member countries. This is probably the reason why the 2011 EU Commission proposal still maintained that the new VAT revenues (accordingly statistically harmonized by the EU Commission) had to be collected on the member states and not directly by citizens. In an academic contest, this is also the reason why Fuest et al. (2015), while in favor of making the payments to the EU budget transparent by indicating them in the VAT receipt of consumers (the same proposal as in Cipriani, 2014), propose a “fictional” rate, computed as the ratio of each country present contribution to the EU budget on the country total VAT revenues, or as the average common percentage of all VAT revenues that would be necessary to finance the EU budget.

On a political economy grounds, both these proposals do not seem very convincing. As we argued above, if the objective is to improve accountability of the European institutions, tax payments to the EU budget must be made visible to citizens/consumers and therefore maintaining indirect payments through the countries’ budgets cannot solve the problem. The idea of a “fictional” EU tax rate, while certainly an improvement in terms of visibility of the EU budget across citizens, would have the defect of being misleading for citizens, as no real flow of resources to the EU budget would actually follow from this “fictional” rate.

Thus, it would seem to be preferable to introduce a true EU VAT rate with revenues paid directly to the EU budget (as in the proposal by Cipriani, 2014), and in case try to correct the difference in definition and monitoring across EU countries by adjusting the GNI-based resources or some other tax resources that might also simultaneously be introduced to finance the EU budget. The need to introduce corrections and adjustment mechanisms would undoubtedly create complexity and opacity at the EU level, and bargaining and conflict across member countries and between the member countries and the Commission, but similar adjustments and conflicts would probably arise with any other conceivable EU tax, and none of the other proposals seem to have the advantages that the VAT has on other grounds (visibility, benefit principle, revenues etc.). Moreover, the introduction of a EU VAT would probably push towards greater uniformity across EU countries on VAT bases and rates, and also leads to more scrutiny by European institutions on national implementation and monitoring mechanisms, both useful outcomes for their own sake.

The same kind of double benefit would seem to clearly emerge in the case of a European tax rate levied on a common definition of corporate income at the European level (CCCT), and with some redistributive mechanism of the tax base across countries, as proposed by the Commission in 2011 (EU Commission, 2011a). It satisfies a benefit principle, because the common market has certainly increased the profitability of the companies operating at the European level, and the adoption of a common consolidated tax base would certainly work in the direction of reducing tax frauds and elusive behaviors, based on profits shifting and the tax avoidance tricks allowed by the different national tax codes. Furthermore, such a tax would not limit member countries’ autonomy in determining the tax rate, and because of the large tax base, even a small EU tax rate would be enough to produce large revenues (although fluctuating with the economic cycle).
Finally, if accompanied by a EU VAT rate, the European corporate income tax would at least give the impression of a balance between taxing consumers and taxing companies (leaving aside the issue of the “true” incidence of the different taxes) that would be important on the political economy grounds.

5.7 Transitory period

As already argued, what is really at stake in the debate about reforming the financing of the EU budget is the nature of the Union. Even the introduction of a limited form of direct taxation on citizens to finance the EU budget, provided that this tax or set of taxes is sufficiently large (that is, covering a consistent part of the EU budget) and visible to taxpayers to establish the principle that the Union has the “right” to collect own resources, is going to produce large changes in the future. This is the “bolder move” that is probably necessary to try to address the legitimacy problem at the EU level, by modifying the funding of the EU budget. Provided this move is taken, however, all steps should be taken in order to make the transition as smooth as possible and create the largest possible consensus across member countries and public opinions.

For instance, it seems advisable that, at least for a period, a role in the financing of the EU budget should be maintained to national contributions (GNI-based) as this would allow to stabilize expenditure and compensate member countries for the variations in payments induced by the shift to own tax financing. Adjustments are probably necessary whichever tax is chosen, for the reasons stressed in the previous paragraph, and having national contributions that can act as a buffer would be important. National contributions should however be reduced sharply in size, going back to the dimensions they had at the time of their introduction (see figure 1).

Similarly, in a transitory period, the Council should be allowed to set up through the MFF the maximum amount of expenditure for each of the year covered by the decision, as proposed by Fuest et al. (2015). Democratic accountability at the European level is still not properly established. European MP’s are not elected at the moment by European citizens to decide on taxes and budget, as they had not played this role before, and it will take time for the political debate at the national and European level, involving the selection of European MPs, to adjust to the new situation. An interim fix budget maximal level would also placate the fears that the Union uses its increased autonomy to excessively expand the budget.

On the other hand, it would not make sense to offer this increased financing autonomy to the EU institutions, with the idea of making them more accountable to citizens, and then maintain the right of the member states to predetermine most expenditure for the next 5-7 years with the MFF approval. This would only increase the conflict between European institutions and frustrate citizens’ demands for representation. Once the maximum amount of spending for a given year is determined,

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22 Tabellini and Persson (2003) study the setting up of the budget in a Presidential system, where budget allocation is seen as the result of a division of roles between the Congress, who sets up the size of the budget, and the President, who chooses where to spend the money. The basic conclusion is that separation of powers induces lower spending than in a Parliamentary system. A similar insight would apply here, with the Council taking the place of the Congress and the Parliament of the President.
the European institutions, through the by now well-established supranational method, should have the chance to freely determine how they want to spend this money.

6. Conclusions

In the previous sections, we revised the debate on the funding of the EU budget, and in particularly on the introduction of a EU tax as an own source of financing for the EU budget. This debate is once again on the fore as the EU Commission would probably put forward a new proposal in 2016, after the rejection by the European Council of the proposal advanced in 2011, and a High Level Group was set up to examine the possible alternatives. In considering the different options, we deliberately adopted a political economics approach rather than a normative or legal one, asking which agents or political forces would benefit from the reform and which agents would instead oppose it.

A key point of the analysis is the adoption of a dynamic perspective; we argue that in order to understand the forces at play, one should ask how a funding reform today might affect the bargaining position of the EU Parliament with respect to the Council in tomorrow negotiations, or more generally how it would change the relationship between the Union and member states. Even a limited change in the source of funding the EU budget, moving in the direction of a EU tax paid directly by the citizens to the EU budget, would lead to a political dynamic strengthening the Union with respect to member states, possibly also putting strains on some fundamental features of the present budget (such as the fact that the EU budget has always to be in equilibrium). Anticipations on this future political dynamics are probably the main reason why some member countries resist the change, while the EU Parliament is pressing for it.

From this perspective, the large discussion in the scientific literature on the “optimal” characteristics of a EU tax seems to be ill posed. What is really at stake in the debate on the EU tax is the nature of the European Union, whether it will remain just a club of sovereign states or it will evolve in a true federation. The answer to this question is more dependent on establishing the principle that the EU budget ought to be financed with own taxes directly levied on citizens than on the specifics of the chosen EU tax. Indeed, we also argue that the criticisms that are raised against the present system of funding of the EU budget make little sense if one takes the view that the EU is, and must remain, just a club of sovereign states, cooperating in providing some common goods and bargaining on some payments as a side issue (the EU budget).

Finally, we also claim that the main rationale for introducing a reform of the EU budget is to cope with the legitimacy crisis that the EU is currently facing. Although it is a risky move, given the present low level of consensus towards the European project, making European citizens more aware of the cost of the EU budget by financing it with a visible EU tax might be a way to force more accountability in European institutions and move European expenditure more in the direction of satisfying citizens’ demands. On these grounds, we have discussed the different proposals concerning the EU taxes and advanced suggestions for a transitory period.
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Appendix – Figures and Tables

Figure 1 EU revenue 2000-2013 (million EUR)

Source: European Commission (2013a), p. 39
Figure 2 Contribution to EU budget as a percentage of GNI and per capita – Deviation from EU-27 average (outturn 2007-2013)

Source: Cipriani (2014), p. 23
Figure 3 Operating Budgetary Balance (2013)

Source: High Level Group on Own Resources (2014), p. 28
Figure 4 European expectations and perceptions of the EU Budget

Note: the figure shows the answers to the following questions QD1: On which of the following do you think most of the EU budget is spent? Firstly? Any others? and QD2: And on which of the following would you like the EU budget to be spent? Firstly? Any others? Source: TSN Opinion & Social (2011)
Figure 5 Trust in the European Union

Note: the figure shows the answers to the question QA8a.8: I would like to ask you a question about how much trust you have in certain institutions. For each of the following institutions, please tell me if you tend to trust it or tend not to trust it. The European Union.
Source: TSN Opinion & Social (Spring 2015)
Figure 6 European Parliament: seats by political group (2009 and 2014 elections)

Note: EFDD, NI and ECR group the different Euroskeptic national parties.