The development of the Communities' and the Union's own resources

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Contributions from the Member States (1958–1970)

The Treaty establishing the European Economic Community (EEC) and the Treaty establishing the European Atomic Energy Community (EAEC or Euratom), signed at Rome on 25 March 1957, introduced a system under which the Communities were to be financed by contributions to be paid by the Member States.

These contributions were to be determined on a scale reflecting each Member State’s ability to contribute (Article 200(1) of the EEC Treaty and Article 172(1) of the EAEC Treaty). Under the EEC Treaty, there was a different scale to cover the expenditure of the European Social Fund (Article 200(2)). Under the EAEC Treaty, there were different scales for contributions to the operating budget and the research and investment budget respectively (Article 172(2)).

Thus, these two Communities were to be financed, like the international organisations, by national contributions.

However, the situation was not intended to be permanent, since the possibility of moving to a system of own funding, independent of the Member States, was provided for in the Treaties of Rome from the outset. Article 201 of the EEC Treaty and Article 173 of the EAEC Treaty respectively laid down that the financial contributions of Member States might be replaced by the Community’s own resources and by the proceeds of levies collected by the Community in the Member States.

Article 201 of the EEC Treaty goes even further, inasmuch as it envisages the replacement of national contributions by a specific category of revenue, namely revenue deriving from the common customs tariff.

After the establishment of a common agricultural policy, the Council decided, in Regulation No 25 of 4 April 1962, that revenue from levies on imports of agricultural products from third countries was to accrue to the Community and to be included in the budget resources of the Community.

At this point, the Community was, therefore, able to envisage that these two sources of revenue might provide it with the beginnings of a system of autonomous financing.

The Commission, which was assigned the task of studying the replacement of financial contributions from Member States, presented a series of proposals to the Council.

In 1965, a first attempt to transfer customs duties and agricultural levies foundered in the face of French opposition. European integration experienced the ‘empty chair’ crisis which was resolved, almost six months later, by the famous ‘Luxembourg Compromise’ in January 1966.

It was only at the Hague Summit of 1 and 2 December 1969 that the Heads of State or Government finally reaffirmed their intention to replace financial contributions from Member States by a system of own resources.

The first decision on own resources (1970–1985)

On 21 April 1970, the Council adopted the decision on the replacement of financial contributions from Member States by the Communities’ own resources. It marked the transition from national contributions, through which the Member States exercised control over the policies initiated by the Communities, to an independent system of financing by **‘traditional’ own resources** (agricultural levies and customs duties) and a **resource based on value added tax (VAT)**.

Under the Decision of 21 April 1970, revenue from ‘levies, premiums, additional or compensatory amounts, additional amounts or factors and other duties established or to be established by the institutions of the Communities in respect of trade with non-member countries within the framework of the common agricultural policy, and also contributions and other duties provided for within the framework of the organisation of the markets in sugar, hereinafter called agricultural levies' was to be entered immediately in the budget of the Communities from 1 January 1971 (Article 2(a)). As the first own resource, **agricultural levies** were introduced in 1962 by Council Regulation No 25. These consisted of taxes charged in respect of trade in agricultural products with non-member states within the framework of the common agricultural policy, on the one hand, and contributions to the production and storage of sugar and isoglucose, on the other. These contributions were internal to the Community, unlike the taxes levied on agricultural imports.

Also under the Decision of 21 April 1970, revenue from 'common customs tariff duties and other duties established or to be established by the institutions of the Communities in respect of trade with non-member countries, hereinafter called customs duties', was to be entered progressively in the budget of the Communities from 1 January 1971 (Article 2(b)). As the second own resource, **customs duties** were levied at the external borders of the Community on imports. The EEC Treaty already provided that revenue accruing from the common customs tariff when it had finally been introduced was to constitute the first of the Community's own resources (Article 201). The common customs tariff was introduced on 1 July 1968.

The 1970 decision also provided that Member States were to receive a refund of 10 % of the amounts of traditional own resources paid, in order to cover **expense incurred in collection** (Article 3(1) subparagraph 5).

These two *traditional own resources* (agricultural levies and customs duties) are regarded as *natural* own resources because they constitute revenue collected on the basis of Community policies rather than revenue received from the Member States.

However, they were not sufficient to finance the Community budget, so revenue from another source was required.

Article 4 of the decision of 21 April 1970 accordingly introduced, from 1 January 1975, a third own resource: **resources accruing from VAT**. This resource differs from the others in that it reflects the level of economic potential in the Member States. It is obtained by applying a given rate to a VAT base determined in a uniform manner for the Member States on the basis of Community rules. In other words, it is a levy on revenue accruing from VAT collected in each Member State. This resource is obtained by applying the Community rate to a taxable item determined according to the rules of the uniform base.

That rate was not to exceed *a call-in rate of 1 %*. The actual call-in rate was fixed each year at the end of the budgetary procedure in the light of the expenditure not covered by the other own resources. The function of this third resource was, therefore, to balance the budget.

A uniform basis for assessing VAT was defined in the Directive of 17 May 1977. However, the budget was not financed entirely from own resources until 1980 because of delays in certain Member States in introducing the necessary amendments to their legislation on VAT.

The Communities were also to have **other resources** at their disposal. Article 4 of the 1970 decision provides that 'the budget of the Communities shall, *irrespective of other revenue*, be financed entirely from the Communities' own resources.' The existence of other resources is, therefore, officially sanctioned. They include, among others, deductions from Community staff salaries, wages and allowances, interest on late payments and fines, various taxes, revenue from the sale of publications, EAEC loans, etc.

The EEC Treaty made no provision for the Community to **borrow or lend**. However, on the basis of Article 235 of the EEC Treaty, it has assumed that power, restricted initially to loans to help countries in difficulties (balance of payments loans) and subsequently extended to include the financing of investment projects proposed by various countries.

This system of own resources with a ceiling of 1 % for revenue accruing from VAT lasted for over ten years, but the Community's shortage of financial resources, combined with the explosion in common agricultural policy expenditure, the accession of Greece in 1981 and the prospect of enlargement to include Spain and Portugal prompted the Council to amend the 1970 Decision on own resources.

The second decision on own resources (1985–1988)

The Decision of 7 May 1985, adopted after the Fontainebleau summit of 25 and 26 June 1984, did not change the system of own resources.

In order to augment own resources while retaining the existing sources of revenue, the **maximum rate of mobilisation of VAT own resources** was raised from 1 % to 1.4 % with effect from 1 January 1986 (Article 3(2)).

The principal innovation in this Decision was the introduction of a system for the **correction of budgetary imbalances**, designed to establish a permanent mechanism for financial compensation to be granted to the *United Kingdom*. The latter, having drawn attention to the imbalance between the costs that it bore as a result of its membership of the Community and the financial return that it obtained from membership, was granted a reduction in its payments to the Community in respect of revenue from VAT. This rebate was equivalent to 66 % of its net balance. The cost of financing this compensation was to be shared by the other Member States *pro rata*, according to their participation in the revenue from VAT, with the exception of *Germany*, whose share was reduced by one third (Article 3(3)).

Despite the increase in the maximum call-in rate for VAT from 1 January 1986, it soon became apparent that the Community budget was insufficient to cover the ever-growing costs associated with the extension of Community activities into new fields (as a result of the Single European Act) and the accession of new Member States. Similarly, traditional own resources were dwindling. The Community had become more and more self-sufficient in the agricultural sector and had reduced its imports, thereby causing a fall in revenue arising from import taxes. The Community had also granted a large number of tariff reductions of various kinds, so customs revenue had also declined.

As the Commission pointed out in its communication of 15 February 1987, ‘Making a success of the Single Act: a new frontier for Europe’ — generally known as the ‘Delors I Package’ — the current system was exhausted. The Community needed to have an adequate system of own resources that could provide it with a reasonably lengthy period of ‘budgetary stability’. A further increase in the maximum call-in rate for VAT alone would not provide a lasting solution. The Commission therefore recommended that a fourth resource be created and that a ceiling for own resources be introduced.

The European Council meeting in Brussels on 11, 12 and 13 February 1988 acted on the Commission communication and prepared a thorough overhaul of the system of own resources.

The third decision on own resources (1988–1994)

The Decision of 24 June 1988 established a new system for financing the Community budget, applicable from 1 January 1988.

This Decision introduced a <u>fourth resource</u> based on the gross national product (GNP) of the Member States: **the GNP resource**. This was to be obtained by the application of a rate to be determined under the budgetary procedure to a base representing the sum of all the Member States’ GNP established in accordance with rules to adopted in a directive (Article 2(1)(d)). Designed to balance the Community budget, the rate was calculated by reference to the difference between expenditure and the yield of all the other own resources, hence its description as *an additional resource*. The reference to GNP was to enable the relative prosperity of the Member States to be taken into account and the burden of Community financing to be shared between them in an equitable manner.

The same Decision fixed **a maximum amount of own resources** corresponding to a percentage of GNP. It therefore introduced the principle of a ceiling for the total amount of the own resources to be assigned to the

Community. This ceiling, fixed at 1.15 % in 1988, was to increase progressively and reached 1.20 % of the total GNP of the Community in 1992 (to cover payment appropriations) (Article 3). Thus, this new mechanism enabled the European budget to be index-linked to developments in the economic prosperity of the Community.

Revenue from VAT, which had lost its function as a balancing resource, was adapted to take account of the disparities between the Member States associated with differences in their patterns of consumption. The rate of VAT remained at 1.4 %, but the assessment base to be taken into account for any Member State was not to exceed 55 % of its GNP. This is the principle of **capping the VAT base** (Articles 2(4)(a) and 2(1)(c)).

The mechanism of **compensation granted to the United Kingdom** was slightly modified to take account of the capping of the VAT base and the introduction of an additional source of revenue (Article 4). The Decision confirmed the arrangement which limited *Germany's* share in financing this compensation (Article 5) and introduced a temporary abatement up to 1991 for *Spain* and *Portugal* (Article 9).

The Decision also specified that **customs duties** on products coming under the **EAEC** Treaty were to be entered in the Community budget (Article 2(1)(b)). In fact, the common customs tariff does not apply to EAEC products.

At the end of the period during which the graduated limit on the total amount of own resources applied (1992), and in order to tackle the increase in the Community's expenditure resulting from the extended responsibilities arising from the Treaty on European Union (EU Treaty), the Commission once again turned its attention to the system of own resources.

In its communication of 11 February 1992 'From the Single European Act to Maastricht and beyond: the means to match our ambitions' — generally known as the 'Delors II Package' — it drew attention to the regressive character of the VAT resource which penalised the least prosperous Member States unduly, since a large proportion of their GNP was normally spent on consumer goods. The Commission presented proposals to the Council on corrections to reduce the relative proportion of the VAT resource in the Community's resources and bring the resources paid by each Member State into line with its ability to contribute.

The Heads of State or Government, meeting in Edinburgh on 11 and 12 December 1992, approved the amendments to be made to the 'third decision'.

Moreover, while the 1970 Decision had devised a system of Community financing based on own resources, it was the EU Treaty — which entered into force on 1 November 1993 — that amended Article 201 of the EEC Treaty and Article 173 of the EAEC Treaty, thereby officially sanctioning that system of autonomous financing.

And, as part of the overall revision, the EU Treaty also repealed the articles fixing a scale for financial contributions from the Member States (Article 200 of the EEC Treaty and Article 172(1), (2) and (3) of the EAEC Treaty).

The fourth decision on own resources (1994–2000)

The Decision of 31 October 1994 — applicable from 1 January 1995 — was adopted at the end of the European Council meeting in Edinburgh on 11 and 12 December 1992. It fixed the level of Community resources for the period 1995–1999 on the basis of the same system as the preceding decision but made a number of changes.

In order to reduce the role played by VAT revenue in Community financing and, in so doing, to take more account of the Member States' ability to contribute, this Decision provided for the progressive reduction of the **call-in-rate of the VAT resource** from 1.4 % to 1 % between 1995 and 1999 (Article 2(4)(a)).

From 1995, the **ceiling for the VAT base** was fixed at 50 % of GNP with regard to Member States whose per capita GNP in 1991 was less than 90 % of the Community average. This amendment was extended progressively between 1995 and 1999 to all the Member States. In this way, the least prosperous benefited more from capping (Article 2(1)(c)).

The **ceiling for the total amount of own resources** (for payment appropriations) was revised upwards in order to increase Community revenue. It was to rise from 1.21 % to 1.27 % of the total GNP of the Member States between 1995 and 1999 (Article 3(1)).

In its communication entitled 'Agenda 2000: for a stronger and wider Union', dated 16 July 1997, the Commission emphasised that the financial effects of future enlargement of the European Union to include the countries of Central and Eastern Europe must be taken into account. It considered that the existing system of own resources need not be amended and could very well continue to apply in the period 2000–2006.

The system of own resources was assessed by the Commission in a report dated 7 October 1998. The report noted that the reforms introduced by the 1988 and 1994 own resources decisions had resulted in a reduction in the relative importance of VAT contributions in the budget. In addition, the volume of traditional own resources was diminishing as a result of trade liberalisation. The importance of the GNP resource in the budget had, consequently, increased considerably.

The report judged the operation of the system of financing on five criteria: appropriateness, equity, financial autonomy, transparency-simplicity and cost-effectiveness. Following this analysis, it presented options for reforms designed to simplify the system, improve its cost-effectiveness and transparency and increase the Union's financial autonomy. The report also included proposals for the introduction of new own resources.

On the basis of this report, the European Council meeting in Berlin on 24 and 25 March 1999 determined the adjustments to be made to the Union's system of financing but refrained from introducing any new own resources.

The fifth decision on own resources (2000–2006)

The Decision of 29 September 2000, which entered into force on 1 January 2002, met the wishes expressed by the Berlin European Council.

In order to continue the process of taking account of each State's ability to contribute and to reduce revenue from VAT, **the maximum rate of call-in of the VAT resource** was to be reduced to 0.75 % in 2002 and to 0.50 % in 2004 (Article 2(4)(a)).

For the same reasons, **the ceiling for the VAT base** remained fixed at 50 % of GNP for each Member State (Article 2(1)(c)).

In order to enable the Union to develop its policies and prepare for further enlargement, **the ceiling for own resources** (to cover payment appropriations) was maintained at 1.27 % of Community GNP (Article 3(1)).

The 2000 Decision also provides for a technical adaptation to make use of the latest statistical concepts. In the 1995 European system of integrated economic accounts (ESA 95), the concept of GNP was replaced by **GNI (gross national income)**. In that decision, GNP is accordingly defined as being equal to GNI. As a result, in order to maintain the amount of Community resources at the same level, the ceiling for own resources as a percentage of the Union's GNI was adjusted to a value of 1.24 % (Article 2(7)).

As regards traditional own resources, the fraction that Member States were allowed to retain so as to cover **collection costs** was increased from 10 % to 25 % from 1 January 2001 (Article 2(3)).

The **compensation granted to the United Kingdom** was maintained, subject to the application of two technical adjustments designed to offset the windfall gains resulting from the increase in the percentage of traditional own resources retained by Member States to cover collection costs and pre-accession expenditure (Article 4(e) and (f)).

Germany, the Netherlands, Austria and Sweden were to pay only one fourth of their normal share in financing the United Kingdom rebate. The remaining three fourths was to be covered by the other 10 Member States (Article 5(1)).

Finally, the Commission was to undertake, before 1 January 2006, a general review of the own resources system, including the effects of enlargement on the financing of the budget, to consider the possibility of creating new autonomous own resources and to review the system for correcting budgetary imbalances, particularly the compensation granted to the United Kingdom.

On 14 July 2004, the Commission adopted its report on the operation of the own resources system. This report drew attention to the complexity and insufficient transparency of the system for EU citizens and to the increasingly limited financial autonomy of the Union. It also drew attention to the need to reform the mechanism for correcting budgetary imbalances.

In the light of these observations, the Commission opted for a system of financing based on the traditional own resources, the GNI resource, and — to replace the VAT resource levied on the ‘statistical notional harmonised’ VAT bases of the Member States — a new fiscal resource. In this connection, it proposed either fiscal resources based on energy consumption (a levy on fuel used for road transport or aviation), or a fiscal VAT resource (application of a Community rate to national VAT bases), or a resource based on corporate income (a levy on corporate tax). The Commission also called for the new resource to be introduced by 2014.

With regard to the correction of budgetary imbalances, the Commission considered that the United Kingdom’s situation was no longer unique, and it therefore recommended a general correction mechanism.

The Commission’s proposals are currently being considered by the Council and the European Parliament as part of the negotiations on the next financial perspective for the period 2007–2013.