

Towards a new way to finance the EU budget? Reflections on the Monti Report

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Executive Summary

- > The current system of European Union (EU) own resources is running out of steam and contributes to exacerbating the tensions between EU member states, especially net contributors and net beneficiaries.
- > The prospect of a Brexit should be considered as an opportunity to reform the system in order to simplify it, make it more transparent and more democratic.
- > As long as member states keep focusing on accounting calculations, the EU budget cannot be an efficient investment tool, enabling the EU to deliver the full potential of its policies.
- > The Monti Report, while not seeking to increase the overall volume of EU spending, aims at finding novel ways of financing the EU budget, to make it less dependent on member states' contributions.
- > In a general context of budgetary restrictions, it seems most unlikely that member states will agree on radically changing the EU's own resources, however – unless a strong political will to deepen EU integration develops among the EU-27.

The EU's budget is a lens through which the European integration process can be observed. Having a sound budget is a major precondition for this integration process to proceed and succeed. However, with national contributions accounting for about 85 percent of the EU budget, and the ongoing net payer debate, the financing of the EU budget is mainly influenced by accounting calculations (Mathis 2015). These do not

reflect the real benefits and added value of the EU budget and can be considered as thwarting the initial rationale of giving the EU 'the means necessary to attain its objectives and carry through its policies' (Article 311 TFEU). It is therefore widely agreed that the current system of financing the EU budget is no longer viable. Additionally, the uncertainties linked to the upcoming Brexit negotiations are equally bound to have a major impact on the EU budget. With the UK leaving, the EU budget could be reduced by up to ten billion euro a year (Ducourtieux 2017).

A reformed budget would reflect the general level of ambition, unity and credibility the political leaders want to bestow on the EU. It would be a signal of a strong willingness to equip the Union with real means for economic growth, an affirmation of political power, and a way of asserting a complete balance between its two legislative branches (Hagemann 2014). What is true for the way the money is spent also applies to the way EU resources are identified. This is reason enough to seek new and alternative ways of financing the EU budget.

As a contribution to the broader debate about the EU's next Multiannual Financial Framework (MFF) and the structure of its budget, further fuelled by the recent publication of the European Commission's Reflection Paper on the Future of EU Finances (2017a), this policy brief builds upon and assesses the Monti Report. The report, published in December 2016, contains guiding principles (fiscal sovereignty and neutrality, general volume, progressivity of the implementation) and guidelines that are clearly oriented towards finding resources directly linked to EU policies, 'European public goods', and towards making the link – for the first time – between revenue and spending. It also proposes to move towards a more transparent, simple and equitable system of own resources, granting the EU more autonomy from the member states. Indeed, as

long as member states keep focusing on the flows of money and their *juste retour*, the EU budget cannot become an efficient investment tool, enabling it to respond to the current challenges and to deliver the full potential of its policies. As such, the budgetary problem is real, and the Monti Report, while not seeking to increase the overall volume of EU spending, aims at finding new ways of financing the EU budget in order to make it less dependent on member states' contributions.

This report is however not the panacea. The main challenge lies in the national veto positions, and ways to overcome those. It is most unlikely that member states, in a general context of national budgetary restrictions, will agree on radically changing the EU's own resources system. The subjacent problem of the budget debate could be viewed as the opposition between a long-term rational approach (the need to change the way the EU budget is financed following the Treaty rationale and giving more leeway to the EU to finance its policies) and a short-term political reality (in a context of national electoral deadlines and austerity). It might therefore be difficult to convince member states to give up their grip on the EU budget, and cutbacks are more likely to be made to the spending.

Before presenting a preliminary assessment of the Monti Report, the policy brief outlines the state of play of the EU's resources.

EU own resources

State of play

Despite major evolutions over the years, the Treaties have always promoted EU financial autonomy through the principle that 'the budget shall be financed wholly from own resources' (Article 311 TFEU). After an initial period of financing by means of direct national contributions, 'traditional own resources' (mainly customs duties and agricultural levies) were introduced in 1970. In the late 1970s, those were complemented with a Value-Added Tax (VAT) resource, which gradually became the main source of funding until the late 1990s. Over time, its proportion has however declined, and is now at approximately 15 percent of the total EU revenue. With the gradual development of new policies and rising expenditures, a new resource based on member state contributions was eventually established in 1988. Over time, this Gross National Income (GNI)-based resource has been growing to become the predominant part of the EU revenue (d'Oultremont and Mijs 2013). At the same time, an increased use of

correction mechanisms has been developing, in which member states tend to focus primarily on their own net financial benefits.

A reform is arguably needed to allow the EU budget to be financed almost fully by 'genuine own resources', closely linked to expenditure, enabling a maximum leverage effect and freeing the EU budget from the omnipresent accounting calculations. However, one could also argue that, despite the numerous correction mechanisms and the fact that it is mainly based on GNI-based resources, the current system works rather well and is to the liking of most member states (d'Oultremont and Mijs 2013). Furthermore, aiming for a reform would mean opening a real debate on the EU budget (amongst other on the financing of the EU institutions), which could ultimately lead to a debate on European integration itself (Cipriani 2014). In the actual climate of rising populism, the appropriateness of launching a debate on the EU budget could therefore be questioned as well.

Reforming the EU's own resources

The process of reviewing and reforming the financing of the EU budget is not new (Fuest 2015). Already in March 2007, French MEP Lamassoure urged for a two-stage approach in order to reform the financing of the EU budget: first abolish all corrections and rebates, and subsequently implement a new system of own resources (Lamassoure 2007).

In a 2011 resolution on the Multiannual Financial Framework, the European Parliament argued anew for an 'ending of existing rebates and correction mechanisms' and for the 'introduction of new genuine own resources as a way to contribute to financial stability and economic recovery' (European Parliament 2011). During the negotiations on the 2014-2020 MFF, the Parliament managed to secure the creation of a High Level Working Group on Own Resources (HLGOR) under the leadership of former Italian Prime Minister Monti and composed of Members designated by the European Parliament, the Council of the EU and the European Commission. Its mission was to conduct a general examination of the EU's existing own resources system and to consult national parliaments through an interinstitutional conference, to find more transparent, simple, fair and democratically accountable ways to finance the Union.

The final Monti Report, presented in the European Parliament and the Council in January 2017, advocates for a substantial reform of the EU budget, requiring

changes both on the expenditure and revenue sides. The report presents nine recommendations, which can be summarised according to three rationales: 1) having 'genuine' own resources strictly linked to the EU's activities and competences, contributing to EU objectives; 2) focusing on the provision of public goods; 3) not increasing the volume of the EU budget via new resources, but using these latter to decrease national contributions while keeping the fiscal burden on citizens stable.

The Monti Report: a possible way forward?

The general acknowledgments of the Monti Report, and the needs it underlines, remain to a large extent similar to the insights of the 2007 Lamassoure Report. Based on the observation that a major proportion of the EU's resources cannot be considered as genuine own resources, but merely contributions coming directly from the national budgets (by means of GNI-based contributions) and from a VAT-based income (which cannot be considered as genuinely EU-owned), the shortcomings of the current system of financing of the EU budget are undeniable.

Despite the fact that the Monti Report gives a general impression of being more consensual, factual and at the crossroads of the points of view of the different institutions, it adopts an overall severe stance on the current role of the EU member states and their general attitude towards the EU budget.

The key recommendations of the Monti Report

The Monti Report aims first and foremost at sharing one general idea, rather than making concrete proposals. In order to evolve towards a more transparent, simple and democratic budget, it emphasises an overall change of paradigm. If one was to single out one key element from this report, it would be the overarching recommendation to strive for more 'European added value'. To a much larger extent, both for the revenue as for the spending sides of the EU budget, member states should reflect on the purpose of the European budget, therefore aiming at more investment and an increased leverage. In order to assess this 'European added value', the report proposes possible ways forward.

Although it was not actually part of its mandate, the Monti Report attaches great importance to the link between expenditures and revenues. It pays considerable attention to the intrinsic political value of each potential resource proposed. This logic is seen as a way to formulate European policies, but also to increase the proximity between the EU budget and its citizens.

Indeed, the Monti Report repeatedly emphasises the lack of direct link between the EU budget and its real contributors. By proposing to use more resources directly related to European policies – for instance the common market or environmental policies – a clear link would be established between revenues and spending, going beyond a mere redistribution of money. Efforts could and should therefore to a greater extent be concentrated on areas where the EU can really make a difference, such as the provision of EU-wide public goods. From a national perspective, however, lending political support to spending on EU wide-public goods is less attractive and more difficult to translate into net financial benefits that a member state government can sell to its population.

The Monti Report also contemplates making use of differentiation in terms of public policies (for instance enhanced cooperation, the Eurozone), which would be accompanied by budgetary differentiation. This would mean having a 'variable geometry' Europe, involving a 'variable geometry' budget. This approach may seem inevitable in the longer term, especially in light of the options presented in the White Paper on the Future of Europe (European Commission 2017b), but will have to take into due consideration the power balances within the Union, if it is to avoid adding a new layer of complexity to the EU's budget. The search for simplification being one of the central elements of the HLGOR's recommendations, it will be essential to adjust the financial aspects of the budget to the functions the budget will have to fulfil. As an illustration, the choice of the financing of the Eurozone will be crucial, not only because it will lead to differentiation, but also because it will have an impact on the Union's overall governance.

Linked to the need for simplification, the current fragmentation of the EU budget is another recurring theme of the Monti Report, as it is seen as presenting several threats, not the least in terms of democratic accountability. In this context, the correction mechanisms and rebates are subject to many critiques, mainly due to the complexity and the lack of transparency they generate. Admittedly, these mechanisms are the result of political negotiations, but they do not contribute to the general legibility of the EU budget and they disrespect the deeper attention policy-makers should pay to the aforementioned 'European added value'. Brexit is therefore considered as the ultimate opportunity to rethink the whole correction and rebate structure. Asserting the 'European added

value' as a central value of the EU budget would ideally make correction and rebate mechanisms obsolete.

A final option for a reform of the EU's own resources is to give more leeway to the European Parliament, and increase its budgetary powers on the revenue side. More precisely, by reducing the amounts of financial means coming directly from the member states a greater margin of manoeuvre could be offered to the EU as a whole and to the European Parliament in particular. Member states would no longer be able – at least not to the same extent as is currently the case –, to claim the same scrutiny rights on the allocation of European spending. Both EU legislators could therefore be given a more complementary share in allocating the EU budget. Such a measure would potentially help reducing the focus on the *juste retour* and enable a budget that is more globally directed towards furthering shared European interests rather than narrow national demands.

Assessing the Monti Report

The Monti Report evaluates all the existing and potential new resources that were studied, including a CO₂ levy/carbon pricing, the inclusion of the EU emission trading system proceeds, a motor fuel levy, an electricity tax-based own resource, a common consolidated corporate tax base, an EU corporate income tax, a financial transaction tax, a bank levy, a reformed EU VAT and *seigniorage*, in light of eight criteria: equity/fairness; efficiency; sufficiency and stability; transparency and simplicity; democratic accountability and budgetary discipline; focus on European added value; subsidiarity; limited political transactions costs. The idea of assessing resources by means of such criteria is not new. However, the systematicity of this approach, without eventually prescribing one resource, could be considered as a major strength of the report. As all the proposed resources are evaluated in a similar way, the report provides a consistent analysis of various options, which decision-makers can use to select their preference.

In this context, it has to be noted that different sets of criteria will influence what is considered as 'best options'. Depending on the importance granted to one or the other criterion, what will be considered the 'best option' might change. Based on their political views, policy-makers could require potential new own resources to match different sets of criteria, without it meaning that – objectively – one option is better than the other. Although most of these principles (simplicity, transparency, equity and democratic accountability) are

well-established, the array of options proposed to decision-makers will at least have the merit of urging the member states to face their responsibilities and allows for a new way of considering the EU budget.

Moreover, it has to be underlined that some studied resources, such as the carbon tax, the emissions trading system or a transport tax, could have a broader – not solely budgetary – impact. Indeed, by favouring a decarbonisation or an energy transition, the budget becomes immediately linked to one of the major EU policies. This raises a fundamental concern, which is the potentially high degree of political resistance that such proposals could generate, further dividing the Union.

Lastly, the Monti Report is not free from shortcomings. The absence of a discussion of clear mid- and long-term impacts of some of the proposed resources, as well as the risks of political trade-offs and the introduction of new complexities, weaken the report.

Above all, however, the acceptance of the prescribed change of paradigm will to a large extent depend on the willingness of the member states. They will have to decide unanimously (Article 311.3 TFUE) if they want to provide the EU with genuine own resources. The diagnosis established by the Monti Report, crucial as it may be, only provides a basis for this discussion, touching upon a series of highly delicate and politically sensitive matters.

Conclusion

To conclude this overview and preliminary assessment of the Monti Report, one can certainly argue that the proposed analysis based on objective criteria entails many benefits. The introduction of genuine own EU resources would be a return to the spirit of the Treaty, and would be likely to mitigate the narrowly defined national interests, the *juste retour* issue and increase the pursuit of EU policy objectives.

The budgetary problem is real, and as long as member states keep focusing on accounting calculations, the EU budget cannot be an efficient investment tool that enables the Union to deliver the full potential of its policies. The Monti Report, while not seeking to increase the overall volume of EU spending, has the merit of offering tentative solutions by finding new ways of financing the EU budget in order to make it less dependent on member states contributions.

However, given that it is so closely intertwined with the core of state sovereignty, the debate about genuine own resources speaks to fundamental questions about

the future and *finalité* of the European integration process. In a context of budgetary restrictions, it seems therefore most unlikely that member states will agree on radically changing the EU's own resources. Only a fundamental decision on the future of Europe could settle the issue of reforming the financing of the EU budget. Whether the necessary political will to deepen EU integration develops in the years to come is highly doubtful. In the absence of a radical overhaul of the existing system, addressing the issue of own resources

in a structured way – based on the suggestions of the Monti Report – would therefore already have to be considered as representing progress in itself.

Further Reading

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