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Future of the European Union's Budget revenues – New own Resource based on Value added Tax

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Abstract

Current legal regulations concerning European Union's budget revenues are considered to be exceedingly complex and unclear both for professionals and citizens of the European Union countries. The main reason of the indicated problem is connected to the resource based on the value added tax and the own resource based on gross national income. This situation led to intensive work on the new own resources of the EU that would ensure financial autonomy in order to operate efficiently. Therefore, European Commission proposed two new types of revenues – financial transaction tax and new own resource based on VAT. The aim of this article is to present the new VAT-based revenue of the EU budget. Apart from the legal issues empirical analysis will be taken into consideration in order to examine whether new resource can be perceived as a stable source of EU revenues. Presumption of the impact of the economic situation on the VAT amounts collected by EU Member States is supported by recent financial crisis that affected majority of the European Union Countries. The analysis is carried out using linear regression model, where aggregated VAT revenues of EU are treated as dependent variable while aggregated gross domestic product of EU are used as explanatory variable. The study is conducted for years 2004-2012.

Keywords: New VAT, own, resources, European Union's, budget, revenues.

Introduction

The European Union Budget is of great importance for the European Union (EU) because of the role of this organisation. All European nations benefit from activities such as opportunities for student to study abroad, making an easier access to other markets especially for small companies, diverse forms of subsidies, a fair business environment, a coherent tax policies, a sustainable growth policies, benefits for every UE citizen at the local, national and European level like: safer toys, new roads, food etc. In order to ensure feasibility of the established programmes there has to be a certainty that financial situation can enable this. This is why European Union has to be equipped with appropriate funds.

Financial provisions are described in articles 310 and 311 of the Treaty on the Functioning of the European Union[1]. Article 310 states that revenues and expenditure of the organization should be presented for each fiscal year in the budget. This budget is created by the European Parliament and the Council. However, there are additional provisions for actions of these administrative bodies. They are included in article 314 of the Treaty on the Functioning of the European Union. The budget must be balanced and all expenditure should be authorised. Before making any expenses there must be adopted a legal binding Union act that provides a legal basis for its action and also for covering expenditures in accordance with appropriate regulations.

The budgetary discipline is an important issue while adopting acts concerning expenditures because there must be an assurance that European Union is able to finance each expense from its own resources and they are in accordance with multiannual financial framework. The implementation of the budget must be in compliance with the principle of sound financial management. Member countries should also collaborate with the UE in order to ensure that all resources obey this rule. In this article, there is also a relevant provision concerning a duty to counter any kinds of fraud or any illegal actions that could affect European Union finance[2].

The 311th article of the Treaty on the Functioning of the European Union provides information about the Union's own resources. There is a sentence which is very crucial: "The Union shall provide itself with the means necessary to attain its objectives and carry through its policies." That means that creating an appropriate budget is an extremely important issue. However, there is also a statement that indicates a prohibition to damage any other budgets. The decisions concerning the system of own resources of the European Union are adopted unanimously, acting in compliance with a special legislative procedure by the Council and after consultations with the European Parliament. In this way the new resources can be established or existing ones can be abolished. However, these decisions must not enter into force before being approved by all EU countries. The maintenance of compliance with respective constitutional requirements of Member States must be observed. The power of the Council to implement measures for the

European Union's own resources is limited[2].The original articles included in the Treaty on the Functioning of the European Union were reformulated in the Lisbon Treaty Amending the Treaty on European Union and the Treaty Establishing the European Community[3].

This article aims in general at presenting the future of the budget revenues and the particular possible new own resource based on value added tax. Therefore it must be stated that current legal regulations allow dividing revenues into four groups[4]: i. traditional own resources (TOR), ii. the own resources based on value added tax (VAT), iii. other revenues, iv. the resources based on gross national income (GNI).

Traditional own resources consists of customs duties, agricultural duties, sugar and is glucose levies. Every type of revenues concerning traditional own resources is presented in Council Decision of 7 June 2007 on the system of the European Communities' own resources. Article 2 points each of the resources that are considered to be traditional own resources. These are: levies, premiums, additional or compensatory amounts, additional amounts or factors, 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, customs duties on products under the expired Treaty establishing the European Coal and Steel Community as well as contributions and other duties provided for within the framework of the common organisation of the markets in sugar[5]. Until 2014 25% of the amounts were retained by Member States to cover collection costs[6] and after January 1 2014 it was decreased to 20%[7].

The second source of the European Union's revenues comes from VAT. This type of resource was created in April 1970, when it became clear and apparent that traditional own resources generated insufficient amounts to cover the expenses. However, because of the harmonisation problems, this resource was introducedin 1980[8]. The calculation process of the appropriate amount of VAT required to be transferred from each Member State to EU budget is very complex and is perceived as incomprehensible both for professionals and individuals. Although there is a uniform percentage rate fixed at 0, 30% for most of the countries, it is applicable to harmonised VAT base[9]. This base is limited to 50% of each European country gross national product (capping) and does not represent the actual VAT revenues of each country but is created by the estimated value of all goods and services liable to VAT. Moreover, there are also specified exemptions and compensations granted to particular countries that hamper the procedure of determining the proper amount of VAT that need to be transferred by each country to EU budget[5].

Other revenues includes among others EU institutions staff contributions to the pension scheme, proceeds from taxation on the remuneration, proceeds from the sales of properties (movable and immovable), proceeds from the sale of publications, fines from firms that do not obey EU competition rules, interest paid by EU countries when the obligatory payments of contributions are delayed, revenue from operations of borrowing and lending funds[10].

The last source of EU budget revenue based on gross national income (GNI) is also called the "fourth source" because it was introduced in 1988 due to the necessity of covering imbalances of the EU. The reason to arise them resulted from the difference between the expenses and the resources coming from traditional own resources, VAT-based payments and so called "other revenues"[11]. The calculation is quite simple: planned size of the income from the three previous sources is subtracted from the planned expenditures of the EU budget. The outcome is the size of the GNI resource. However, the share of each country in the contribution for the GNI depends on the ratio of a country's GNI in the European Union's GNI. The methodology of the calculation of payments due from each Member State is to split the previously received outcome by the quantity of EU GNI, and then multiply this result by the height of the GNI of the Member State[12].Those payments are defined as direct ones, because the money comes directly from national budgets of the European Union countries. This is why GNI payments cannot be considered as a real own resources of the EU. Moreover, the connection between them and European Union citizens and companies is very hard to find[13].

The size of each source of EU budget revenue presents figure 1. The share of GNI-based resources has been continuously increasing since 2009 whereas the share of VAT revenue has been diminishing. That is a problem that needs to be solved in order to ensure sufficient financial resources for EU to operate.

Therefore, this article is divided as follows: material and methods, results and discussion, and conclusion. The next section (material and methods) presents a brief analysis of EU VAT revenues that at the moment of implementing this source of budget revenue were perceived to ensure a substantial part of financing EU expenditures. Then the article provides results of the research and detailed discussion concerning proposals of implementing new types of revenues – financial transaction tax and new own resource based on VAT that would replace current VAT-based resource. The last part of the paper is devoted to conclusion and indicates the added value of the paper that can be identified as a possible guideline for EU policy makers while restructuring EU budget revenues.

Material and Methods

The main aim of this article is to analyse the relation between aggregated VAT revenues of all European countries and the economic situation measured by aggregated gross domestic product (GDP) of all Member States. It must be noted that the data were obtained in each year only for countries that were EU Members. This would be the base for the further discussion and analysis weather restructuring EU budget revenues so as there would be a greater share of VAT-based resources is appropriate. In order to conduct a research the data provided by European Union and Euro stat was used.

The method of analysis chosen is the linear regression model where aggregated VAT revenues of EU are treated as dependent variable while aggregated gross domestic product of EU are used as explanatory variable. The analysis is conducted for years 2004–2012 because the data for years 2013–2014 are not available yet. The descriptive statistics of the data used in the research presents table-1.

According to table-1 it should be stated that all data used are expressed in million EUR. The mean value of all VAT receipts in European countries in 2004–2012 was €821 679 million whereas the aggregated GDP was €12 323 164 million.

While adopting linear regression model a basic assumption must be obeyed. The independent (explanatory) variable must be correlated with the dependent variable[14]. Therefore, a Spearman's rank correlation was calculated. The coefficient of 0,933 was significant at p<0, 0500 and it allows to state that the required assumption is fulfilled.

Results and Discussion

The previous parts of this article provided a theoretical background for the research. The results of the analysis of the economic situation's impact on the VAT revenues of European Union countries present table-2 with linear regression results.

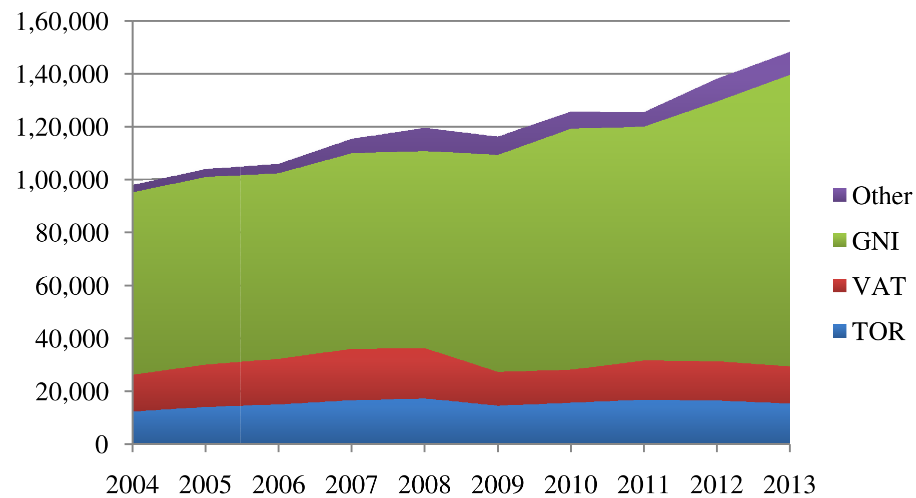

Figure-1
The size of each type of EU budget revenue in 2004–2012 in million EUR

Table-1
Descriptive statistics

	Descriptive statistics				
Variable	**Valid N**	**Mean**	**Minimum**	**Maximum**	**Standard deviation**
VAT	9	821 679	707 710	912 245	69 400
GDP	9	12 323 164	10 740 360	13 357 120	898 401

Table-2
The linear regression results of the impact of GDP on VAT in Europe in 2004–2012

	Beta	**Standard Error of Beta**	**B**	**Standard Error of B**	**t(7)**	**p-level**
Intercept			-106011	80889,782	-1,310	0,231
GDP	0,974	0,084	0,075	0,007	11,495	0,000

All marked correlations are significant at p<0,0500. The independent variable (GDP) was significant at the 99,99% level which indicates very good explanatory power of the created linear model.

Table-3
The linear regression summary statistics

Statistic	Value
Coefficient of determination	0,949
F(1,7)	132,149
p	0
Standard error of estimation	16640,369

Presented in table-2 and table-3 estimated regression coefficients enabled to build the following model:

$$VAT = \underset{(0,007)}{0{,}075GDP} - \underset{(80889{,}782)}{106011} \pm 16640{,}369.$$

The estimated GDP coefficient enables to state that as GDP of all EU countries grows by one unit the VAT income of all Member States grows by 0,075 million EUR. The coefficient of determination of 0,949 means that 94,9% of the total change in VAT revenues depends on the change of GDP. Therefore, it must be noted that the model (1) explains 94,9% of the variability of VAT revenues in European countries. The standard error of estimation indicates that average empirical VAT income fluctuates by 16640,37 million EUR.

The analyses conducted are very weighty for further discussion connected to replacement the old statistical VAT-based source of EU budget revenues that is perceived to be non-transparent and too complex.The new VAT own resources system would be much simpler and more effective due to the direct link to the tax base[15]. Moreover, there would probably be implemented the financial transaction tax. This tax is to be stable source of EU revenues paid by financial institutions that should participate in financing the cost of economic perturbations that were particularly visible after the last *subprime* financial crises[16].

The new own resource based on VAT was proposed by European Commission in 2011. The main arguments of implementation were the increase of explicitness and transparency for European Citizens and reinforcement the stability of EU budget revenues[17].

The conception is that the standard tax rate in each Member State is divided into two separate rates – one is under the control of the particular country and the second is consistent with the EU law and represents the contribution to the EU budget – a single EU rate. It is worth noting that in each European Union country there are: one standard rate which cannot be lower than 15% and can be two reduced rates, however, the lowest rate of their establishment is at least 5%. The single EU rate is proposed to be of 1% and would be applicable to all goods and services taxable to the standard VAT rate in all European countries. The amounts of VAT collected in each Member State that corresponds to the EU rate would be then transferred to the EU budget. Hence, there would be a direct link to the actual VAT receipts that stems from transactions taxable to the standard VAT rate. It also means that a European Citizen (a final consumer) would pay a real contribution to the common EU budget. Moreover, it would enable to eliminate the statistical VAT-based resource that in reality differs from the factual VAT revenues in particular country. The calculation of new VAT own resources would be much simpler and there would be no need to implement any adjustments or correction mechanisms that are applicable in current regulations of VAT-based resources[15].

European Commission presented in 2011[18] the projection of changes of the EU budget revenues structure. The replacement of the statistical VAT-based resource with the new VAT own resources and financial transaction tax would be supported by the traditional own resources, other resources and GNI-based. However, the share of GNI-based resources would be significantly reduced. Figure-2 presents a comparison of actual EU budget revenues collected in 2013 and the European Commission projection of revenues in 2020 after restructuring the EU budget.

The statistical VAT-based resourcesaccounted for only 10% of the total EU budget income in 2013. The European Commission expects to increase the share of the new VAT own resources up to 18% of the total EU revenues. However, it should be emphasized that a bigger income is to be obtained from the financial transaction tax (FTT) – about 23%. The GNI-based resources would be considerably decreased from 79% to 40%.

The replacement of the old statistical VAT revenue by a new VAT own resources is very desirable. As it was mentioned before, there are a lot of arguments in favour. However, the reinforcement of income from this source can be perceived also as a risky undertaking. The analysis conducted in this article indicates a strong correlation and linear relationship between the European Union countries' economic situation and the VAT receipts collected by them. The estimated model showed that almost 95% of the VAT income variability depends on the variability of the GDP. Empirical data presents table-4.

The analysed period overlaps with the recent financial crisis that affected almost every Member State. This can be noticeable in particular in 2008–2009 when the GDP drop caused even greater decrease of VAT receipts collected by all European countries. This phenomenon indicates that granting a larger importance of VAT income to the EU budget can be hazardous since in periods characterized by economic turmoil the EU budget would receive lower income. It should be stressed that in terms like this there is a greater need for a financial help towards European countries, especially those in euro area[19].

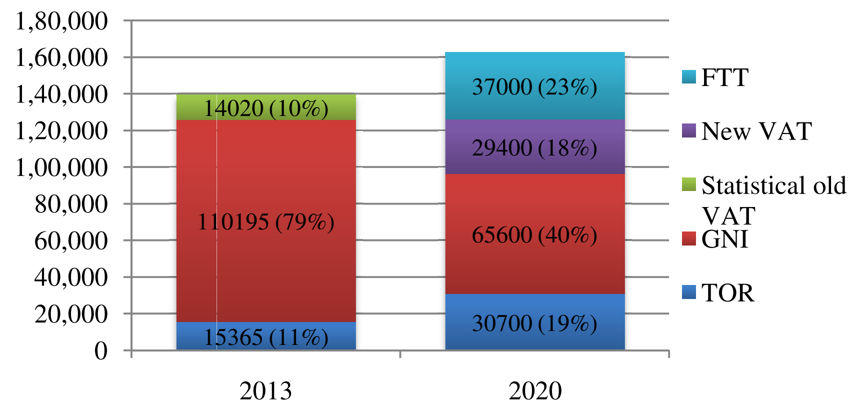

Figure-2
EU budget revenues – actual in 2013 and projected in 2020

Table-4
EU countries GDP and VAT receipts in million EUR and as a % change y/y

Year	EU countries GDP (in million EUR)	EU countries GDP change (in %, y/y)	EU countries VAT receipts (in million EUR)	EU countries VAT receipts (in %, y/y)
2004	10 740 360	5,2%	707 710	6,4%
2005	11 209 144	4,4%	745 371	5,3%
2006	11 839 277	5,6%	793 196	6,4%
2007	12 832 846	8,4%	860 721	8,5%
2008	12 915 503	0,6%	849 917	-1,3%
2009	12 181 275	-5,7%	776 809	-8,6%
2010	12 725 881	4,5%	854 877	10,0%
2011	13 107 072	3,0%	894 261	4,6%
2012	13 357 120	1,9%	912 245	2,0%

However, the greater role of the new financial transaction tax that would be applicable to financial institutions could probably ensure proper EU budget revenues. FTT would be applied on shares, bonds and securities at the rate of 0,1% and on derivatives transactions at the rate of 0,01%. There is a high support of European citizens for implementing this tax in order to prevent excessive trading activities executed by financial institutions that contributed to the recent financial crisis and to force them to pay the costs of it[20].

European Commission proposed to introduce two new types of own resources from January 1 2018 at the latest[15]. However, an approval of every EU country is required to come into force a specific directive that regulate the reformed EU budget.

The GNI-based resources – although of lower value – should stay in power. This revenue is perceived to be a residual financing source that enable to make the budget balanced and reflects each Member States economic capacity[21].

Conclusion

The analyses conducted in this article – both theoretical and empirical – allowed examining the undergoing discussion about the EU budget reform. There is no doubt that current legal regulations need to be replaced by new ones adjusted to post-crisis Europe. The complexity and incomprehensibility concerns the most the statistical VAT-based resource which does not reflect actual VAT receipts collected by Member States. The process of calculation of this source is so complicated that even professionals struggle with this. Therefore, it is very unlikely to understand this procedure by ordinary European citizens. Yet, they should be aware of the importance and the method of financing EU budget that is used to fulfil obligations of European Union.

European Commission's proposals of implementing two new sources of EU income will probably come into force in 2018 and therefore will replace the old statistical VAT-based resource. The new VAT own resources are expected to constitute 18% of the total revenues in 2020. Therefore, the role of VAT receipts of every Member State is of great importance. The policy makers should take into consideration that there is a strong linear relations between VAT revenues and the economic situations measured by gross domestic product which was proved in this paper by the estimated linear regression model. Hence, the introduction of an additional source of revenue – financial transaction tax – is indispensable. In addition, it seems inevitable to dispose of the GNI-based resources. They constitute a residual financing source that secure the budget against imbalances.

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