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# Very resourceful: The Monti Report on reforming the EU revenue system

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*The way the EU finances itself has been under criticism for years. Now, Brexit opens the door to comprehensive change, and a working group under former Italian prime minister Mario Monti has recently presented reform recommendations. Reform enthusiasts may be disappointed to see that the Monti Report does not come down in favour of one new revenue source but rather presents and evaluates a broad array of options. However, this may be as much a strength as a weakness. This policy paper summarises the recommendations and provides some context.*

# 1 Introduction

There is one thing almost everyone in the European Union agrees on: the EU budget needs to be reformed. But any change has to be approved unanimously by all EU Member States, and consensus has proven hard to find. On the spending side, an alliance of ‘net contributors’ regularly clashes with a coalition of ‘net recipients’ over the size of the EU budget (currently around 1% of the EU’s Gross National Income) and the best way to use it. How this amount is raised has also been the subject of heated debates, although the question has received less public attention. Partly, because a fundamental reform of the revenue system was out of the question if it touched upon the UK rebate, the discount on British contributions that Margaret Thatcher negotiated in the 1980s.

Against the backdrop of Brexit, a comprehensive overhaul has suddenly become more likely. It is therefore fortunate that last month, after almost three years of deliberation, the ‘High-Level Working Group on Own Resources’ under former Italian prime minister Mario Monti has presented its [recommendations on the reform of the EU’s revenue system](#), formally known as ‘own resources’ system. This blog post provides a summary and a preliminary assessment. Why does the current system need reforming, what does the report propose and what are possible next steps?

## 2 Why reform the EU revenue system?

Today, the EU is mainly financed via three sources:

- **13%: Traditional Own Resources**, mainly consisting of customs duties. The EU is a customs union where tariffs on imports are only collected at the first point of entry. Therefore, Member States do not keep tariff revenue but rather pass it on to the European level. They retain a cut of 20% as collection costs.
- **12%: National contributions based on a consumption tax** (‘VAT-based own resource’). These contributions were originally based on EU Member States’ income from the value-added tax. Over time, efforts to ensure that no country is treated unfairly have led to the introduction of adjustments like caps and special call rates. As a result, the calculation is now enormously complex and the result has little to do with Member States’ actual tax revenue.
- **69%: National contributions based on economic prosperity** (‘GNI-based own resource’). These contributions are based on the Gross National Income of EU Member States. While the original purpose of this resource was to make up for any shortfalls, it has become the main pillar of EU financing by now.

This system is widely criticised for two main reasons. First, it sets problematic incentives. Today’s revenue sources are legally ‘own resources’ of the EU in the sense that Member States cannot deny their payment. But in practice, many Member States treat VAT-based and GNI-based contributions as transfer payments to the EU. Much energy is spent on

minimising expenses and on maximising returns ('net balance' thinking). As a result, EU money is often not spent on the most relevant issues but rather spent in specific countries.

Second, the revenue system is riddled with exceptions that foresee rebates, rebates on the rebate, reduced call rates and lump-sum payments. It has become so complex that citizens as well as politicians struggle to understand it. This lack of transparency hinders democratic control and risks fostering mistrust against the common budget or the EU in general.

### 3 What does the report propose?

Among the nine measures the Working Group proposes, four recommendations are especially notable:

- 1) **Replace most national contributions with 'genuine' own resources.** The VAT-based resource in its current form should be abolished and the GNI resource should be used only to fill gaps. 'Genuine' own resources must fulfil two criteria: First, they should be connected to EU competences (e.g., help the functioning of the Single Market or support the EU's environmental goals). Second, they should be the EU's own in the sense that the revenue accrues directly to the EU, not to Member States who later transfer it to the EU. Customs duties are cited as an example of a 'genuine' own resource (see figure 1).
- 2) **Find new indicators to measure countries' costs and gains** related to EU policies. 'Net budgetary balances' should no longer be used as primary metric because this fuels the perception that the EU budget is a zero-sum game.
- 3) **Abolish all rebates and corrections** in order to simplify the revenue system. This concerns not only the UK rebate, but also measures that currently reduce the contributions of Austria, Denmark, Germany, the Netherlands and Sweden. Instead, the choice and configuration of revenue sources should ensure a fair burden-sharing. When this is temporarily not enough to avoid undue hardship, balance can be achieved through lump sum payments.
- 4) **Allow some 'differentiated integration' projects to be financed from special revenue**, not from the general EU budget. The development of the euro area and cooperation on defence are named as examples.

## 4 How to choose new revenue sources?

If some of the old revenue sources need to be replaced, how can Europe identify better ones? This is a topic that the Working Group has explored in detail in a [preliminary report](#) dating back to 2014. It establishes the eight criteria for evaluating potential revenue sources. They are summarised below:

- **Fairness.** Do all Member States contribute according to their ability? Do rich EU citizens contribute more than poor ones?
- **Efficiency.** How costly is it to generate the revenue?
- **Sufficiency and stability.** Does the revenue source generate enough income? Does it do so reliably?
- **Transparency and simplicity.** Is it easy to understand how the revenue is raised?
- **Democratic accountability.** Is the revenue source subject to adequate democratic scrutiny and does it help replace national contributions?
- **Focus on European added value.** Does the revenue source support EU objectives?
- **Subsidiarity.** Does raising revenue curtail the national or sub-national governance levels in their respective competences? If yes, are there advantages to raising the revenue at the European rather than the national level?
- **Political feasibility.** How easy is it to agree on the new revenue source and how contentious is the process of raising revenue?

As the report acknowledges, the exact meaning of the criteria is often contested. For example, perceptions of fairness vary according to ethics and the individual's personal situation. In some cases, this limits the criteria's usefulness because the report does not clearly indicate which of several competing definitions it ultimately adopts.

## 5 What are the candidates for a new revenue source?

Reform enthusiasts may be disappointed to see that the report does not come down in favour of one new revenue source but rather presents and evaluates a broad array of options. It is the report's simultaneous strength and weakness that it considers all of them in great detail. By evaluating twelve potential revenue sources according to eight different criteria, it lays the groundwork for an informed debate in the future.

Nevertheless, leaving too many options on the table will not help the reform process. There are some objective guidelines that could have been used to narrow down the selection. The sufficiency criterion illustrates this nicely. Five out of twelve potential revenue sources are judged to be unable to create sufficient stable income. They could at best provide complementary revenue. The report argues that a combination of several sources should be envisaged. But if the goal is to simplify the EU revenue system, replacing GNI-based contributions with a combination of eight new sources of income will not help. A still long, but more manageable list of high-revenue options would include own resources based on:

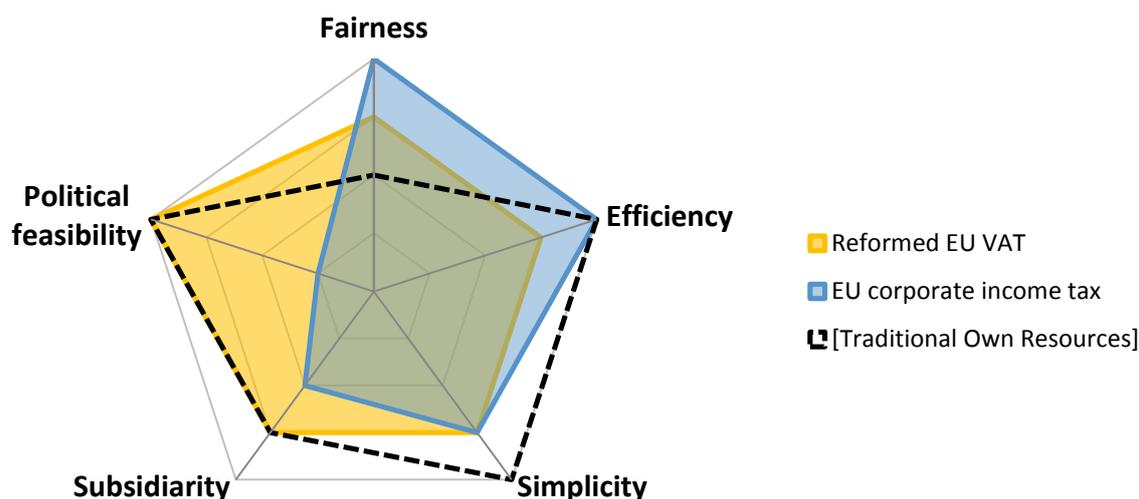
1. A reformed, simplified **value-added tax**,
2. an EU-wide **corporate income tax** building on a harmonised tax base (CCCTB),
3. a **motor fuel levy** that would replace national levies in part or entirely,
4. a **tax on electricity** production or consumption,
5. a **CO2 levy** that either taxes emissions directly or CO2-intensive products.

All five revenue sources are considered in the report and they are scored according to the eight criteria. Below, I have visualised the Working Group's assessment. For easier comparison, I have also included the scores of today's Traditional Own Resources as a benchmark of what the Working Group considers to be a good option.

The potential revenue sources are grouped according to their policy area. The first two are connected to the functioning of the Single Market, while the latter three support European environmental goals. Note that I have only taken into account revenue sources that would generate enough stable revenue to be a major pillar of the EU budget. The accountability criterion was excluded because it seems to have been applied inconsistently. The European added value criterion was not taken into account because all proposed revenue sources score highly on it.

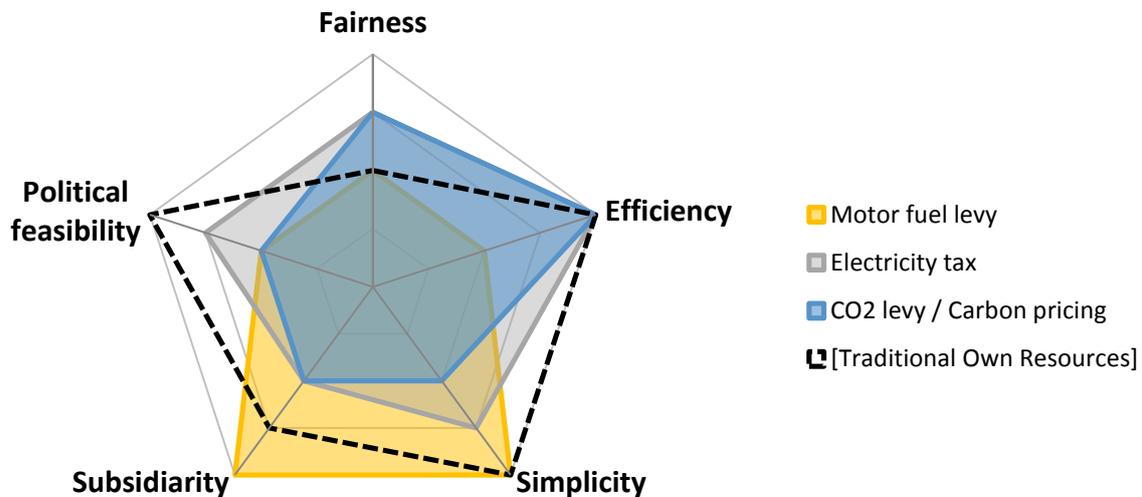
The radar charts illustrate that the Working Group is right to claim that there is no such thing as a perfect revenue source. Combining them could ensure that most criteria are adequately taken into account, but doing so would add complexity to the system. Alternatively, prioritising the criteria would help find the best revenue source.

**Figure 1: Possible EU revenue sources based on the Single Market**



Source: Authors' representation, based on data from [Monti et al. \(2016\)](#).

**Figure 2: Possible EU revenue sources based on environmental goals**



Source: Authors' representation, based on data from [Monti et al. \(2016\)](#).

## 6 How does the report contribute to the reform debate?

The Working Group is careful to take into account the political obstacles to reform. It presents its proposals as part of a possible package deal, which would also include restructuring the EU budget's spending side, the Multiannual Financial Framework. This could help bridge the divide between net contributors to the EU budget, who prefer expenditure reform, and net recipients, who favour changes to the revenue sources. It also proposes a stepwise introduction of reforms that would make changes contingent on progress in harmonising the tax base or in overhauling EU spending.

Abolishing the EU's convoluted rebate system is urgently needed in order to increase transparency. Brexit offers a unique window of opportunity in this regard. At the same time, it raises new political hurdles. Scrapping the rebate system entirely would increase the contributions of countries like Austria, Germany, the Netherlands and Sweden. They are among the largest net contributors today and [will likely have to pay more](#) after 2019, when the EU faces a €10 billion budget gap as a result of Brexit. The Working Group proposes configuring new revenue sources in such a way that rebates are no longer needed but that will be difficult as long as there is no consensus on the question what a fair burden-sharing would look like. Does it mean that a country should not pay much more into the EU budget than it receives, or does it mean that each Member State should contribute according to its economic strength?

Finding new indicators to measure the gains and costs arising from EU policies would be immensely helpful in the medium term because it would broaden the notion of a 'net benefit' that countries derive from EU membership. As the report remarks, it could also help emphasise that common spending is often a positive-sum game. However, finding such new indicators is bound to be difficult especially in those areas where European cooperation is crucial. It may be possible to estimate the effects of Single Market membership or of increased capital flows, but what is the monetary value of safe borders or a coherent defence policy? It is understandable but unfortunate that the report does not get more specific on these challenges. The debate on this key topic is still in the very early stages.

Communication is key to win support for any reform proposal. Independently of specific reforms, framing a reform of the EU budget in a way does not spook an already wary European public is hard. Although the report takes pains to emphasise that it does not call for a larger budget and that new revenue sources would merely replace existing ones, the report is [bound to be interpreted as a call for 'more money'](#). A potential antidote might be a slightly smaller budget that could still have a large effect if it becomes more flexible and more targeted. Additional funds may be needed for advanced projects like the further development of the euro area and for cooperation on defence. It is therefore important that the Monti report does not insist on a unified revenue system for all EU projects but allows for (limited) exceptions when it comes to differentiated integration.

Overall, the Monti Report is a balanced document, sometimes to the degree that it puts balance before clarity. It establishes some common ground, but the crucial questions on fairness and measurement are left to political negotiations. The report's timetable is comparatively ambitious but realistic. The authors have been careful to stress that no changes to the European Treaties are needed to implement their recommendations. Consequently, they call for a joint reform of revenue and expenditure before 2021.

What are the next steps? According to the [declaration that defined the Working Group's mandate](#), it is now up to the European Commission to distil the various recommendations into an initiative. The sad fate of the Five Presidents' Report has shown that even joint proposals of several institutions can easily get stuck after this stage if there is no consensus in the Council. But since the loss of the British contribution to the EU budget will force far-reaching changes in any case, there is some hope that Europe will seize the opportunity.