THE FEDERAL TRUST

Enlightening the Debate on Good Governance

How to pay for Europe?

Iain Begg

European Essay No.5

A Definition of Federalism

Federalism is defined as 'a system of government in which central and regional authorities are linked in an interdependent political relationship, in which powers and functions are distributed to achieve a substantial degree of autonomy and integrity in the regional units. In theory, a federal system seeks to maintain a balance such that neither level of government becomes sufficiently dominant to dictate the decision of the other, unlike in a unitary system, in which the central authorities hold primacy to the extent even of redesigning or abolishing regional and local units of government at will.'
(New Fontana Dictionary of Modern Thought)

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Introduction

The love of money may be the source of all evil, but that is not an argument against sensible budgeting. The European Union budget is now close to 100 billion euros a year, and not surprisingly there are strong interests in play determining both what it is spent on, and where the money comes from.

Professor Begg's essay succinctly describes the arguments around how this sum is raised. He highlights the logical and semantic contortions of member states trying to circumvent the Treaty description of money in the budget as the Union's 'own resources'. He pinpoints some of the issues of principle behind the constantly shifting figures for this or that state's 'contribution'. The capacity of member states to fudge an issue has on occasion been of great political assistance, but fudging the issue of money which national taxpayers - who are also European citizens - have to pay helps nobody. Transparency should start with the budget.

It is an observation generally agreed that there should be no taxation without representation. Member states appear to be so scared that European citizens will take this axiom seriously that they prefer to obfuscate the issue of who pays what into the budget (and who receives what from it) in order that calls for greater democratic accountability do not lead to their logical conclusion, a rationally articulated federal structure of European government. If the link between taxes paid by the citizen for the EU and the benefits received from

Europe were more clearly perceived, would the electorate still tolerate lack of clarity in decision-taking, waste and inefficiency in the European institutions and continuing attempts to marginalise their representatives in the European Parliament?

This essay is timely as there is now an opportunity for reflection following the recent Berlin settlement of the financial perspectives for the next few years and before enlargement to include the first of the current applicant states. We should use it wisely to consider what sort of financial settlement we all want for the enlarged Union. At present the sums involved are easily manageable; Britain's net contribution is less than the UK Treasury's margin of error each year in calculating the national tax take.

In an enlarged Union with more tasks to fulfil - including internal and external security - we need a comprehensive and easily comprehensible budget settlement. Fudge will not last for ever.

Martyn Bond
Director, The Federal Trust

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About the Author

Iain Begg is Professor of International Economics at South Bank University, London, and is the joint editor of the Journal of Common Market Studies. He served from 1994-1997 as the Programme Director of a major research programme on the Single European Market funded by the UK Economic and Social Research Council. He has directed several studies for different directorates of the European Commission and for the European Parliament.

He has published extensively on European policy issues and has been a specialist advisor to the House of Lords' European Communities Committee and House of Commons Trade and Industry Select Committee. Recent publications include work on the EU budget, prudential supervision under EMU, the political economy of EMU and economic adjustment under EMU.

How to pay for Europe?

by Iain Begg

The EU budget has proved to be the catalyst for many an euro-row. Maggie's handbag and French tractors are two of the abiding symbols of past budgetary battles, but at different times nearly all the Member States have had their grievances. Different issues have dominated at different times. Net contributions have long exercised the UK and Germany, and have latterly become a preoccupation of the Dutch, the Austrians and the Swedes. The Spanish, by contrast, have advocated a system of payments which more accurately reflects ability to pay, while others question the payment mechanisms.

At the 1999 Berlin European Council, the EU's leaders agreed a new budget package – the *Financial Perspective* – for the period 2000-06. That a deal was secured then, against the expectations of many, can be regarded as an achievement which forestalled a financial and political crisis. But in many respects what was agreed at Berlin called into question many of the principles previously underpinning the EU's finances and created problems for the future rather than offering lasting solutions.

Aspects of the Berlin agreement that are open to criticism include: the timid reforms of the Common Agricultural Policy (CAP); the insistence on retaining a ceiling of 1.27% of EU GDP for the budget, which effectively excludes any new role for the EU in relation to EMU, let alone CFSP or defence; and the proliferation of side-payments, where money is allocated to a Member State outside the usual scope of an EU programme.[1] In addition, although the system of financing was revised, the outcome is an unsatisfactory mix of funding instruments that neither fulfils the Treaty requirement that the EU be financed by 'own resources' nor follows any discernible principle other than helping to diminish imbalances in net contributions. [2]

The aim of this essay is to look afresh at the vexed question of how we pay for 'Europe'. Although the current system functions to the extent that it keeps the show on the road, it does so more by striking deals that defuse politically sensitive disagreements than by establishing a soundly based financing mechanism. With the advent of EMU and the prospect of enlargement the time is ripe for a review of financing the EU. The first section describes and appraises the EU budget, emphasising the role of 'own resources'. This is followed by a discussion of the principles by which potential tax instruments to fund the EU should be assessed, then an overview of the choice of approaches to paying for Europe. Various potential means of financing the EU budget are then analysed and concluding remarks complete the essay.

The nature of the EU budget

Because the EU is something more than an international organisation, but is manifestly not a fully-fledged federal government, it has no direct equivalent as an institution of governance. It has common policies, some of which necessitate public expenditure, and has come to play an increasingly prominent regulatory role. However, as an inter-governmental entity, the EU is constrained by the agreements made between its Member States. The costs of running the EU consequently amount to more than the administration of other international agencies because it has been given competence over discrete areas of policy. Articles 268-280, Title II of Part 5 of the Treaty spell out the financing arrangements.

Article 268 (ex Article 199) states that 'All items of revenue and expenditure of the Community, including those relating to the European Social Fund, shall be included in estimates to be drawn up for each financial year and shall be shown in the budget.' In addition, the Article provides that 'administrative expenditure occasioned for the institutions by the provisions of the Treaty on European Union relating to common foreign and security policy and to co-operation in the fields of justice and home affairs shall be charged to the budget.' The implication of this last sentence is that if the EU is asked to carry out additional tasks under CFSP or JHA, the resources to do so will have to be found from its budget.

A key provision is set out in Article 269 (ex Article 201) which stipulates that 'Without prejudice to other revenue, the budget shall be financed wholly from own resources.

'The Council, acting unanimously on a proposal from the Commission and after consulting the European

Parliament, shall lay down provisions relating to the system of own resources of the Community, which it shall recommend to the Member States for adoption in accordance with their respective constitutional requirements.' The Treaty spells out how the EU budget should function. The significance of this Article lies in the explicit insistence on the EU having own resources.

Own resources can be defined as taxes or other revenue streams that are assigned directly to an agency or tier of government and are not subject to the decisions (or whims) of another level of government. Various criteria can be adopted for deciding which taxes should 'belong' to which tier of government. In many countries, for example, property taxes are assigned to local government on the grounds that because property is, by definition, immobile, there is a reliable local tax base, while local property owners will share in the benefits of local public expenditure. Other taxes, by contrast, may be difficult to pin down by locality and are, as a result, more often collected by higher tiers of government. Corporate profits, notoriously, can be shifted across jurisdictions by the use of transfer pricing, while avoidance of income tax has long been a game of cat and mouse between the tax authorities and the well-heeled. Even sales taxes can be avoided to some degree by border-hopping and it is widely suspected that the advent of 'e-commerce' will complicate the task of tax collectors.

The current system for financing the EU

To finance its expenditure the European Union has its own resources, essentially tax instruments which Member States have agreed to assign to the Union. At present there are four own resources, as shown below. The first two have been in place since 1971; a system of VAT resources was finalised in 1979; the fourth or 'additional' resource was introduced in 1988.

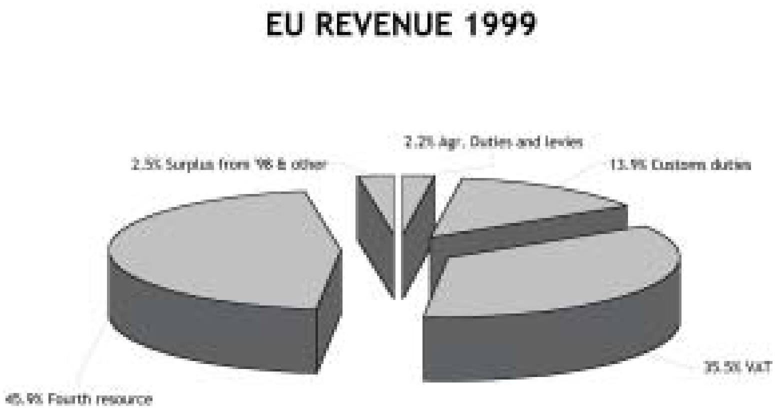
1. Agricultural duties and sugar levies: These are imposed on selected products from outside the EU. In the Berlin agreement, the administrative charge retained by Member States for collecting the duties, currently 10%, will be increased to 25% from 2001, cutting the effective yield of this resource.

2. Customs duties: Proceeds from the Common Customs Tariff, imposed on goods imported from countries outside the EU, are assigned directly to the budget. As with the first resource, the administrative charge of 10% will increase to 25% in 2001, following the Berlin agreement.

3. VAT resource: A proportion of VAT proceeds from each country, adjusted to what is known as a harmonised base, was introduced as an own resource to allow the budget to expand. The maximum rate of call of the VAT resource will be reduced from the present 1% to 0.75% in 2002 and to 0.50% in 2004, as agreed at Berlin. In addition the ceiling set on the proportion of a Member State's GNP deemed to be subject to VAT was capped at 55% up to 1998 and cut to 50% in 1999.

4. Fourth resource: Because of insufficiency of revenue, a fourth resource based on Member State GNP was introduced, under which Member States would pay equal shares of their GNPs. It was intended only to be called upon if there was a shortfall in revenue from the first three resources, but as the budget has grown, it has gradually become a larger proportion of the total. Following the 1999 Berlin agreement, it will become the main source of revenue for the EU.

Over time, the yield from the first two - known as 'traditional' - own resources has steadily fallen. The VAT resource was the main revenue source from its introduction until the mid-1990s, since when the fourth resource has become the most important financing instrument for the budget. The accompanying figure shows the breakdown for 1999.



What distinguishes the EU from nearly all other multi-level governance systems is that the direction of the transfers is from the lower to the higher tier. As shown in the box, the EU is financed from four own resources, with the bulk of the revenue set to come, following the Berlin agreement, from the fourth – GNP-related – resource. The share of the two traditional resources – agricultural levies and duties and customs duties - has fallen steadily because of diminishing tariffs and multi-lateral trade agreements. The VAT resource had become the largest revenue source in the 1980s, but will also shrink post-Berlin because of the agreement to reduce the take-up rate. Henceforth, Member State governments will pay most of their contributions to the EU out of general revenue accounts, so that it will not be related to particular taxes readily identified with the cost of running the EU.

The present system for financing the EU is, in short, one which pays lip-service to own resources but which is actually based on inter-governmental grants. Neither the VAT nor the GNP resource is visible to the tax-payer and governments can choose to finance the latter in a variety of ways, including by borrowing. This may be only of interest to the purist, since what matters in the end is the money raised, but it does bear on accountability. If the electorate cannot establish a link between the policies followed and the bill with which it is presented to pay for these policies, there is little basis for judging the performance of the public bodies in question. Connoisseurs of British local government finance will recall that one of the reasons for the introduction of the poll tax by the Thatcher government was that accountability had been compromised under the rating system.

Choice of taxes to finance the EU budget

There are plenty of tax instruments that could conceivably be used to finance the EU, but any particular tax is bound to be relatively more attractive for some Member States than for others. Many different attributes of taxes enter into the equation. These can be grouped into three broad categories:

- Economic considerations, which encompass criteria derived from theoretical work on public finance and distributive issues. While many of the economic factors are relevant whatever the level of governance, account needs to be taken of the particular institutional character of the EU in applying them. Thus, it can be argued that ability-to-pay (a fundamental principle of taxation) should be applied at the level of the Member State (as the contributor), rather than the individual as is usually the case. Equally, ensuring that any tax does not result in economic distortions is a principle that makes sense at any level of governance.

- Administrative criteria such as the definition of the tax base, the susceptibility of the tax to fraud, avoidance or evasion, the buoyancy and stability of the tax revenues, or the ease of collection. Bearing in mind the differing structures of Member State economies and their legal orders, a tax may be more readily introduced in some countries than in others.

- Political sensitivities will inevitably intrude. Income tax is seen by many countries as a purely domestic concern, and there are social as well as public finance issues in the use of excise duties on fuel, alcohol or tobacco. The compatibility of the tax bases in different countries will also bear on the feasibility of introducing a given tax. Thus, if a tax were to be imposed on wine and not other forms of alcohol, those countries where wine rather than beer is the preferred tipple would pay proportionally more.

In selecting own resources for the EU, one consideration that is always prominent in discussion is the issue of net contributions to the budget. Indeed, many of the changes introduced in Berlin can only be understood in this context. Thus, it is hard to interpret the decision to allow national authorities to retain 25% of the proceeds of traditional own resources (rather than 10%) in any way other than as a device to reduce the Dutch net contribution. Yet the paradox here is that the imbalances in net contributions arise principally on the expenditure side of the EU budget, not its financing.

Bearing in mind political sensitivities, the funding of the EU has to take account of a number of constraints.

- First, gross payments to the EU will have to be broadly in line with each Member State's GDP. A case can be made for a progressive system in which the rich states not only pay more, but also a higher share of their income, but the likelihood is that proportionality will continue to apply. It follows that the means of financing the EU will have to result in payments that correlate well with GDP. This could be achieved by assigning particular taxes to the EU and carrying out an ex-post adjustment or, more simply, by making

GDP the key and leaving Member States free to raise the amounts required in any way they chose.

- Second, there is bound to be a bias against any new taxes, if only because of the political capital that would have to be expended to secure states' agreement, or indeed popular assent.

- Third, because of subsidiarity imperatives, it is hard to see the EU level being given any leeway over rates of tax or the balance between different taxes. The Berlin deal showed how these two elements were critical in massaging net contributions to the budget and it is inevitable that any variation would have implications for the distribution of the funding burden.[3] A second aspect of subsidiarity is the profound suspicion of the Member States about the motives of 'Brussels' and the consequent lack of willingness to cede any control over the EU's finances.

Overall approach to financing the EU

Two approaches to paying for Europe in future can be envisaged. The first would be to come clean about present arrangements and revert to inter-governmental grants as the mechanism. If this were adopted, the pretence that the EU is funded by own resources should be dropped and Article 269 should be redrafted in the forthcoming IGC. The alternative is to take Article 269 literally and seek funding mechanisms that can genuinely be 'owned' (and be seen to be owned) by the EU level.

In practice, the former option is the easiest to establish and implement. Transfers from Member States based on a key (for example GNP) can easily be agreed, require little administration other than the signature of the Minister of Finance on a cheque and can be made to conform to whatever 'fairness' criteria seem most appropriate. Thus, if the political decision is to ask each Member State to pay a specified proportion of its GNP, then it is a simple enough matter to compute what the payment should be. With a budget ceiling set at 1.27% of EU GNP, the club membership fee for each country is the same proportion of national GNPs. There are, it is true, some tricky accounting issues to do with the principles underlying the estimation of GNP, the scale of underground economic activity and differences between Member States in price levels – so-called purchasing power parities – but they are manageable problems.

Similarly, if some degree of progressivity (that is, taking *proportionally* more from the better-off) is desired, it is easy to devise an accounting formula that achieves this. Most income tax systems work in this way and plenty of formulae have been put forward in the EU context. It would even be possible to set thresholds under which a country paid nothing if that made sense. The big advantage of a transfer based system is, therefore, that the Member States would have a known commitment, and it would be easier to focus attention on the spending side of the budget in disputes over net contributions.

The principal drawbacks of a transfer-based system have to do with the certainty of budgeting and the sufficiency of the revenue streams, allied to concerns about transparency and accountability. Dependence on transfers – even if legally robust obligations exist – will always engender some uncertainty about the flows. Other international organisations such as the United Nations or UNESCO have, from time to time, seen subscriptions withheld by member countries unhappy with the direction of policy. There has been no evidence that Member States would blackmail the EU in this way, but it is a contingency that cannot be excluded. The sufficiency risk is that, with a fixed proportion of GNP being transferred, the cash flow the EU level receives cannot be known precisely. If it enters into spending commitments, then finds that it faces a revenue shortfall, it could face legal challenges, especially as it is barred from borrowing.

Transparency in relation to funding the EU is two-edged. Where the EU is unpopular, an inter-governmental transfer from Member States allows the budget to be financed with less risk of provoking a backlash from those opposed to the transfer. Hiding the EU subscription in general taxation in this way could, therefore, be seen as a pragmatic means for governments that acknowledge the worth of membership to lower the visibility of the payments. Equally, it could be argued that it is precisely by making payments transparent that the electorate will be empowered to hold the EU to account. Own resources can, consequently, be seen as a concomitant of democratic accountability.

The principal problem with own resources, however, is that unlike inter-governmental transfers the exact incidence by Member State of the funding of the EU cannot be known in advance. The reason for this is that no matter how cunning the architects of the payments system are, any tax base will evolve through time, altering the shares of the tax burden of different groups of tax-payers. Moreover, it may not be possible to attribute the revenue flows accurately to Member States. The example of the two traditional own resources and the apparently disproportionate Dutch share of them illustrates the impact of these anomalies. First, as multilateral trade negotiations have lowered restrictions and trade has shifted towards intra-EU exchanges, the yield of the two resources has both fallen and been redistributed amongst the Member States, depending on their propensities to import dutiable goods from the rest of the world. The shifts in the relative burdens reflect tastes, national specialisations and particular trading links. Second, although the Dutch Ministry of Finance disputes the point, it is generally accepted that there is a 'Rotterdam' effect stemming from the port's pre-eminent role as the trade gateway to the EU. This means that the Dutch appear to import more than they genuinely consume, with a proportion of the measured imports actually destined for Germany, Belgium or other Member States, and the apparent tax attributed to the Netherlands correspondingly over-stated.

There is, though, another side to the attribution of own resources to Member States that has to be considered. This is that some sources of revenue that might serve as bases for taxation cannot, conceptually, be broken down by a Member State unless a somewhat arbitrary rule of thumb is applied. The proceeds of the common external tariff, in practice, are the result of 'EU' imports, justifying the retention of the traditional own resources by the EU level. Similarly, the profits that the European Central Bank will make, notably from seigniorage[4], are the result of EU-wide monetary operations. Another potential revenue source that exhibits this characteristic is corporate profits, especially where integrated operations and intra-company transactions at administered prices make it difficult to ascertain exactly where profits are generated.

The significance of these supra-national tax bases is that there is a logic to taxing them supranationally. The proceeds could then become the revenue source for the EU budget. However, if the tax yield is greater than required for the budget, further complications would arise in deciding how to deal with the excess revenue. The obvious solution would be to redistribute amongst Member States according to a key such as GNP[5], but there might be advantages in using the revenue to establish some form of equalisation between Member States or establishing the sort of EMU stabilisation fund that has been advocated from time-to-time.[6]

Potential financing instruments

Finding the ideal tax to pay for Europe is not easy, but neither is it as difficult as is sometimes claimed. No tax will possess all the desired qualities, so that the search for an optimal one is more to do with achieving a satisfactory mix. Were it otherwise, the search for a new own resource might not have been so difficult or contentious. The need is to make a choice between alternatives, taking account both of how many of the desired attributes each possesses and the relative importance to be attached to each. However, even with the mutually incompatible aims that politicians are bound to demand (a string of words ending in 'y' such as: equity, efficiency, visibility, buoyancy, sufficiency or accountability), a number of reasonable candidates can be identified.

In its review of financing prior to the Berlin agreement, the European Commission discussed eight options for prospective new own resources. Some of these qualify for the label 'the usual suspects', while others are new additions. The Commission conclusion was that none offered sufficiently compelling characteristics to warrant the political upheaval that change would require. The eight options discussed[7] were:

1 Income tax
2 Eco-taxes
3 Tobacco (and possibly alcohol) excises
4 Corporation tax
5 Withholding tax on interest paid to savers
6 VAT
7 Seigniorage
8 New 'communications' taxes (on, for example, telecommunications or air travel)

A variety of objections can be raised to these various taxes. Some are largely political, notably the objections to income tax and corporation tax; some have to do with the burdens of payment, with some countries liable to face disproportionate payments; while others have to do with the possible ramification of the tax for economic objectives. Whether to look for a single tax to pay for Europe or to spread the load amongst several instruments is also a consideration.

In many respects, VAT is the easiest tax base to adapt, and could be made more visible by tacking on an EU component that would be shown separately. In the US, it is not uncommon for a state and local tax to be demanded simultaneously for some forms of consumer spending, with both items itemised, for example on hotel bills. All EU Member States impose VAT, albeit with variations in coverage across the spectrum of goods and services, and at rates that differ for the 'standard' rate and lower or luxury rates. The main objections to VAT relate to its supposedly regressive character, that is that it falls harder on the less well-off. Countries with higher shares of consumer spending as a proportion of GDP also tend to pay over the odds. Various anomalies can be countered by accounting procedures aimed at establishing fairness between countries, such as by making allowance for wider VAT coverage or adjusting for differences in collection rates. But the problem with these solutions is that, by calculating a notional VAT liability rather than assigning tax actually collected to the EU, the tax in effect becomes an inter-governmental transfer and loses much of its claim to be an 'owned' resource of the EU.

Corporation tax, income tax, withholding tax and excise duties all have in common that their tax bases differ across countries. Relatively more Greeks and

Spaniards smoke, while institutionalised private savings tend to be higher in countries such as the UK or Ireland which rely less on publicly funded pensions. France has traditionally had relatively low direct taxes on income, but has high social charges. There are also variations in concessions or allowances that mean that these taxes, at present, raise significantly different proportions of the total tax take from one country to another. In time, and especially if corporate governance and accountancy rules are more closely approximated across the EU, the viability of corporation tax as an answer may improve, but it is far from an immediate prospect.

Environmental taxes seem to be appealing. They tax 'bads' not goods and thus appear to offer progress on a matter of Europe-wide concern – environmental protection – where many of the problems transcend national borders, while also providing a viable revenue stream. An obvious parallel is the use of steep excise duties to deter smoking: the social policy aim dovetails with financing needs. The trouble with eco-taxes, however, is that they can take many different forms, and will have widely differing properties depending on the option examined. It is, therefore, somewhat disingenuous to regard them as a discrete option. There is, however, a paradox at the heart of using any 'deterrent' tax that is worth mentioning: if they work to curb consumption of whatever is to be deterred (fossil fuels, tobacco or other politically frowned upon targets), the yield from the tax will fall. Unless the proceeds of the tax comfortably exceed the financing need of the government to which they are assigned, the diminution would have to be offset by complementary taxes. But if they do not work to curb consumption of what is being targeted, the burden on consumers of the item may be severe.

One form of eco-tax that has been extensively canvassed in the EU is the carbon tax which would be levied on the use of fossil fuels by energy producers. Given that some countries – France is the extreme case – generate sizeable proportions of their energy from nuclear power, a refinement of the proposal is to tax the oil-equivalent of the energy generated, but at a lower rate.[8] Objections to the carbon tax proposal are that it would be unfair to countries in the North which have high heating requirements, would penalise industrial regions relative to others and (in the absence of a multi-lateral accord) would have an adverse effect on Europe's international competitiveness by raising the costs of production.

Other forms of eco-tax are, however, worthy of examination. Taxing the use of energy by households would obviate the concerns about competitiveness or unfairness to industrial regions, though do little to offset the 'North' factor. The options here would include all energy consumption - although there might be objections on social grounds if pensioners were hit by the tax – or particular pollutants such as petrol for cars. In principle, road tolls or licences to use cars can be thought of as eco-taxes, opening up other options, while taxes could be based on production of domestic waste or other influences on environmental degradation.

A particularly artful means of paying for Europe (at least in part) would be to impose a levy on the use of fertilisers and pesticides. The last two reforms of the CAP have sought to steer it more towards income support for less prosperous farmers. However, the continuation of the price guarantee for so many products means that large-scale intensive farmers, whether 'deserving' or not of subsidy, obtain the largest payments from the CAP. To the extent that their large production is boosted by the use of chemicals that aggravate land and waterway pollution, a tax on fertilisers and pesticides would neatly clawback some of the subsidy.

The proceeds of seigniorage accruing to the European System of Central Banks have been estimated at around 0.3%-0.4% of EU GDP. On the face of it, they ought to be assigned to the EU level for much the same reasons as the two traditional own resources and would constitute as much as a quarter of the budget. As a revenue source, however, seigniorage has recognised drawbacks. It will tend to be low if inflation is low, so that the buoyancy criterion would not work. It is also invisible and hard to explain to taxpayers, raising accountability and transparency questions, although it might equally be argued that invisibility in a revenue source that goes to the EU is an advantage if the intention is to play down the magnitude of spending on (or by) Europe. A more immediate (if perhaps temporary) obstacle is that while some Member States remain outside the single currency, the assignment of the proceeds to the EU would be inequitable.

Communication taxes were a novel suggestion in the report to the European Parliament mentioned in endnote 7. Two of the fastest growing sectors of economic activity are air transport and telecommunications. It was estimated in that report that a modest tax on phone lines (averaging 40 euros per line per year),[9] together with departure taxes based on the then UK and Belgian rates of approximately 15 euros per flight could generate some 25% of the EU's funding. Since then, the proliferation of mobile phones and further growth in air traffic have increased the potential revenue base substantially, so that either the same yield could be attained with lower tax rates, or the two taxes could generate a higher proportion of the funding. The main objections to these proposals include the facts that they would be new taxes (with the presumption that they should be avoided), that they would penalise growing and successful industries that are seen as central to the modern economy, and that they would inhibit cross-border communication.

While these concerns are far from negligible, the proposed taxes would meet several of the criteria for a 'good' tax for paying for Europe. Both air transport and telecommunications are, increasingly, EU-wide industries, regulated at EU level and subject to standards formulated by the Union. Their growth ensures a rising revenue base and it can be argued that 'communications' can afford to be taxed without losing their dynamism.[10] Moreover, with the growth of e-commerce threatening to undermine the ability of governments to collect VAT and other more conventional sales taxes, ways of compensating for this revenue loss will need to be explored. There is a reasonable correspondence between ability-to-pay and the scale of communications activity in different countries, while collection of the taxes from telecoms companies and airlines would be administratively simple. Politically, too, the vast fortunes being made by internet entrepreneurs could well facilitate taxation of the sector. The details of any communications taxes would need to be carefully thought-out to minimise adverse effect, but there is plainly a good case for them.

Concluding comments

Although the Berlin agreement on the EU budget formally settled the size and funding of the EU budget for the period up to 2006, how to pay for 'Europe' is an issue that will inevitably resurface before the financial perspective expires in six years' time. However unwilling the Member States are to make larger payments to the Union, deepening of EMU and the assignment of new tasks to the EU level in CFSP, defence and home affairs are likely to require a rethink. Enlargement of the EU, meanwhile, is bound to raise questions about the size of the payments new members should be asked to make.

Faced with all these challenges, the adequacy of the existing system of own resources has to be questioned. By increasing the proportion of the budget financed by the GNP-related fourth resource the Berlin deal arguably achieves greater fairness in the distribution of the burden of financing the EU. But it means that the principle of 'ownership' of the resources has been flouted, so that the EU has reverted to a system of national contributions similar to that with which it began in 1958.

Budgetary matters are central to the question of what sort of entity the EU is. The choices made on how to finance the budget can, consequently, signal how the EU can be expected to evolve. A first, core choice is whether to finance the EU by inter-governmental transfers or to give it authentic own resources. Current practice is the former, but the Treaty provides for the latter. It is a muddle that ought to be ended.

The second basic choice is how big the budget should be. In the light of the answers to these questions, the next choice is how the funding should be raised. This essay has shown that although different ways of doing so have their merits and drawbacks, there is no shortage of options. What is needed is the political will to move ahead.

[1] For example, the Dutch have been allocated 500 million euros under objective 3 of the Structural Funds for the (unexplained) 'particular characteristics of labour market participation in the Netherlands', while 'A total amount of around 350 million euros will be allocated to Austria inside the Community initiatives' [quotes from the Presidency Conclusions of the Berlin European Council 24-25 March 1999].

[2] For a critique of the Berlin package, see Begg, Iain (2000) 'The EU budget deal: yet another missed opportunity' *European Urban and Regional Studies* 6.

[3] It is also a maxim that those who gain keep quiet while those who pay more will complain vociferously.

[4] This arises because of mandatory deposits by financial intermediaries that only receive low (or no interest).

[5] Broadly, this will happen with the profits of the ECB under present arrangements.

[6] Increasing integration will inevitably place greater demands on the EU level to contribute to both stabilisation and redistribution, especially if an economic downturn in one part of the EU is seen to be the result of, for example, monetary policy decisions that suit one part of the Union much more than others. One model might be the German *Finanzausgleich*, although the EU is some way off having the commitment to solidarity that this would require. Work by the Commission suggests that a stabilisation fund of about 0.3-0.4% of EU GDP would go a long way to mitigate asymmetric shocks (see Italianer and Pisani-Ferry, 1994).

[7] Which correspond to those examined in a study for the European Parliament directed by the present author, an elaboration of which was published (with Nigel Grimwade) in 1998 as 'Paying for Europe', Sheffield: Sheffield Academic Press

[8] The irony here is that an energy source that seems no longer to be politically acceptable, in that proposals for new nuclear plants are unlikely to be approved, would be more lightly taxed.

[9] Apparently the German tabloid newspaper, *Bild*, was scathing in its criticism of 'Brussels' for proposing to tax telephones; undaunted, your author is happy to reassert his paternity of this idea.

[10] It is worth making the point that the cost of the Vodafone takeover of Mannesmann has been estimated at £114 billion (roughly, 180 billion euro at recent exchange rates). This is equivalent to the entire EU budget for two full years.

About The Federal Trust

The Federal Trust's aim is to enlighten public debate on federal issues of national, continental and global government. It does this in the light of its statutes which state that it shall promote 'studies in the principles of international relations, international justice and supranational government'.

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