

**The Next Multiannual Financial
Framework (MFF), its Structure
and the Own Resources**

Margit Schratzenstaller

Research assistance: Andrea Sutrich



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Austrian Institute of Economic Research
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Abstract

The EU budget is facing numerous long-term challenges, which are not adequately addressed, neither on the expenditure nor on the revenue side. Regardless of the future EU integration scenario, a fundamental overhaul of the Multiannual Financial Framework is required. EU expenditure should provide more European added value. Tax-based own resources partially replacing current own resources have the potential to reduce sustainability gaps within member countries' tax regimes as well as to alleviate the juste retour problem.

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Abstract

The EU budget is facing numerous long-term challenges, which are not adequately addressed, neither on the expenditure nor on the revenue side. Regardless of the future EU integration scenario, a fundamental overhaul of the MFF is required. EU expenditure should provide more European added value. Tax-based own resources partially replacing current own resources have the potential to reduce sustainability gaps within Member States' tax regimes as well as to alleviate the *juste retour* problem.

This document was requested by the European Parliament's Committee on Budgets. It designated Ms Isabelle Thomas (MEP) and Mr Jan Olbrycht (MEP) to follow the study.

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LIST OF ABBREVIATIONS

CAP	Common Agricultural Policy
EDF	European Development Fund
GDP	Gross Domestic Product
GNI	Gross National Income
HLGOR	High Level Group on Own Resources
MFF	Multiannual Financial Framework
MS	Member States
ODA	Official Development Assistance
OR	Own Resources
TEN	Trans-European Networks
VAT	Value Added Tax

EXECUTIVE SUMMARY

Apart from and beyond the imminent Brexit and its possible implications for the EU budget, the EU and, consequently, its budget are facing numerous long-term challenges. These range from the recent and imminent enlargement rounds, continuing regional disparities and structural problems of the southern countries over climate change and energy transition; demographic change; decreasing, but still high, unemployment and particularly youth unemployment; increasing inequality of income and wealth and the persisting (risk of) poverty to refugee migration.

The current structure of the EU budget is not able to adequately address these challenges, either on the expenditure or on the revenue side. As with the previous ones, the MFF 2014-2020 contributes too little to the overarching goal of sustainable growth and development, as laid down not only in the Europe 2020 strategy aiming at *“smart, inclusive and sustainable growth”*, but also in the 2030 Agenda for Sustainable Development and, to some extent, in the Paris Climate Agreement of 2015. Overall, the EU budget is characterised by considerable gaps in sustainability on both the expenditure and revenue sides.

EU expenditure provides too little *“true”* European public goods, and thus too little European added value. The EU system of own resources, which is mainly based on national contributions, neither reflects nor directly supports central EU policies such as sustainable growth and development. This furthers a *“juste retour”* perspective of Member States, who are trying to maximise national benefits from EU expenditure, in return for their national contributions. Overall, regardless of the future EU integration scenario, an overhaul of the MFF with fundamental changes for the EU budget with a longer-term perspective is required.

Agricultural subsidies should be reduced significantly; and they should support environmental and employment goals and be targeted more towards the less wealthy Member States. Cohesion funds should be shifted from the *“richer”* to the *“poorer”* Member States and should be coupled more strongly with climate and employment goals and a pro-active migration policy. Expenditure for research and innovation should be significantly increased, with a specific focus on environmentally and socially relevant aspects. Expenditure for cross-border energy and transport infrastructure should be significantly increased as part of a European decarbonisation strategy. Funds to substantially contribute to an internationally coordinated approach to the mitigation of the worldwide *“refugee and migration crisis”* should be significantly increased; as well as funds for development assistance to help the EU as a whole to reach internationally agreed official development assistance targets.

Along with substantial reforms within EU expenditure, the EU system of own resources needs to be overhauled fundamentally. Tax-based own resources can be a tool for further European integration. In addition, they have the potential to reduce economic, social, environmental, and institutional sustainability gaps within Member States’ tax regimes. Taxes, which cannot be enforced effectively at the national level due to tax competition and taxes on cross-border externalities (e.g. carbon emissions), are obvious candidates. These could include an EU-wide carbon-based flight ticket tax, a carbon border adjustment tax, a fuel tax, a net wealth tax, a financial transactions tax, or a common (consolidated) corporate tax base. A basket of tax-based own resources is preferable to introducing one single tax-based own resource. Tax-based own resources would not require genuine taxation

powers of the EU, but revenue could be transferred from Member States to the EU budget based on a remittance system. Tax-based own resources should replace part of the current own resources. Primarily, the complicated VAT-based own resource should be eliminated. The size of the future share of tax-based own resources in overall EU revenue will depend on the integration scenario pursued. However, considering the existing sustainability gaps in Member States' tax systems and in the EU system of own resources, the next MFF should, in any case, include revenue from sustainability-oriented tax-based own resources.

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1. GENERAL APPROACH FOR THE NEXT MFF

KEY FINDINGS

- The MFF 2014-2020 contributes too little to the overarching goal of sustainable growth and development.
- The lion's share of agricultural subsidies does not actively support a transition to environmentally sustainable production and tends to have a regressive impact on distribution.
- Cohesion funds are not redistributed to the "poorer" Member States in a focused and targeted way and, too often, lack any European added value.
- Research expenditure still accounts for a comparatively low share of overall expenditure, and only a small fraction actively promotes a socio-ecological transition.
- Too little funding is made available to development assistance and an internationally coordinated approach to the mitigation of the worldwide "refugee and migrant crisis".
- The system of own resources does not support central EU policies such as sustainable growth and development.
- Regardless of the future EU integration scenario, an overhaul of the MFF, with fundamental changes for the EU budget with a longer term perspective, is required.

Apart from, and beyond, the imminent Brexit and its possible implications for the EU budget (Haas and Rubio 2017a), the EU and, accordingly, its budget are facing numerous long-term challenges. These range from the recent and imminent enlargement rounds, persisting regional disparities and structural problems of the southern countries over climate change and energy transition; demographic change; decreasing but still high unemployment and youth unemployment in particular; increasing inequality of income and wealth and persisting (risk of) poverty, to refugee migration.

1.1. LESSONS TO BE LEARNED FROM THE MFF 2014-2020

The current structure of the EU budget is not able to adequately address these challenges, either on the expenditure or on the revenue side. As with the previous ones, the MFF 2014-2020 contributes too little to the overarching goal of sustainable growth and development, as laid down not only in the Europe 2020 strategy aiming at "*smart, inclusive and sustainable growth*" (European Commission 2010), but also in the 2030 Agenda for Sustainable Development (European Commission 2016a) and, to some extent, in the Paris Climate Agreement of 2015. Overall, the EU budget is characterised by considerable gaps in sustainability on the expenditure as well as on the revenue side.

1.1.1. Structure of expenditure

Núñez Ferrer et al. (2016) correctly point out that a certain restructuring of EU expenditure towards areas creating EU added value has taken place in the more recent past. However, the EU budget in its current structure still provides too little "true" European public goods, and thus too little European added value (HLGOR 2016). Heinemann (2016) shows that EU funds still finance too many projects creating local added value only; supporting a "*juste retour*" perspective of Member States (MS) trying to maximise national benefits from EU expenditure, in return for their contributions. This is one of the most important reasons why net contributor countries, despite increasing European challenges, are becoming more

reluctant to top up, or even just to uphold, the current volume of the EU budget. It is also why a growing proportion of EU citizens appear not to perceive any direct benefit from the EU budget in their own lives. Despite some long-term shifts in spending priorities, the MFF 2014-2020 is still dominated by the common agricultural policy (CAP), consuming a decreasing, but still substantial share of 39% of overall expenditure; and by cohesion policy, amounting to 34% of overall expenditure. An increasing, but still moderate share of 13% is dedicated to competitiveness and infrastructure (including research expenditure). Only about 2% of overall expenditure is dedicated to development assistance within the regular EU budget¹. Schengen-related spending (asylum, migration, borders and internal security) amounts to 1% of the current MFF only.

With regard to the above-mentioned current strategic orientations and long-term goals of the EU, the current expenditure structure shows various sustainability gaps:

- Expenditure for agricultural policy today is mainly preserving existing, conventional production structures within the “first pillar” of the CAP (Bonfiglio et al. 2014). A large share of agricultural subsidies is granted to large agricultural units, prioritising conventional agriculture. With regard to smaller farms, instead of actively supporting a transition to environmentally sustainable production, a large part of income support is granted unconditionally. The more sustainability oriented “second pillar” of the CAP, which could actively support organic farming and rural employment in smaller units, currently amounts to less than one quarter of overall agricultural spending. After several reforms, the CAP still tends to have regressive effects on regional and personal income distribution (Núñez Ferrer and Kaditi 2007, Núñez Ferrer et al. 2016).
- Structural and cohesion policy focuses too strongly on traditional infrastructure projects favouring traditional material (large-scale) infrastructure, too often lacking a European added value (Heinemann 2016). Moreover, as “richer” MS are benefiting from subsidies within agricultural and cohesion policy to a substantial extent, funds are not redistributed to the “poorer” MS in a focused and targeted way.
- Expenditure for research, which has been shown to have a particularly large effect on growth and productivity (Núñez Ferrer et al. 2016), and for infrastructure still accounts for a comparatively low fraction of overall expenditure. Only a comparatively small share of R&D expenditure actively supports a socio-ecological transition in the EU: for example, 20% of overall research expenditure in the current research framework programme Horizon 2020 are dedicated to climate related R&D - twice as much compared to the previous 7th framework programme (FP7) (Veugelers 2014), but well below the envisaged target of 35% (European Commission 2016b).
- Too little funding is made available to make a sufficient EU contribution to development assistance in general and to an internationally coordinated approach to the mitigation of the worldwide “refugee and migrant crisis” in particular. In 2016, Official Development Assistance (ODA) by the EU and its MS amounted to 0.51% of GNI², thus still lagging considerably behind the target of 0.7% of GNI.

¹ In addition, another EUR 30 billion are foreseen within the European Development Fund (EDF) outside the MFF.

² <http://www.oecd.org/dac/financing-sustainable-development/development-finance-data/ODA-2016-detailed-summary.pdf>.

1.1.2. EU system of own resources

The current system of own resources (OR), which primarily rests on contributions from EU MS (for a detailed description, see Schratzenstaller et al. 2016), certainly has its merits (Núñez Ferrer 2008, Begg 2011, HLGOR 2016):

- It provides steady, predictable and reliable revenue to finance EU expenditure;
- It guarantees a balanced budget;
- It establishes (at least *ex ante*, i.e. before the application of the various correction mechanisms) a “fair” distribution of the financial burden across MS;
- National contributions respect the subsidiarity principle by leaving the decision on the distribution of the financial burden among individual taxpayers to MS (Lipatov and Weichenrieder 2016).

Nonetheless, the current financing system has been attracting various criticisms over recent decades (Schratzzenstaller et al. 2017):

- The increasing dominance of direct contributions out of MS’ national budgets to the EU budget, which is continuously curtailing the EU’s financial autonomy (European Commission 2011a, Iozzo et al. 2008) and furthers a *juste retour* logic with all the negative impacts associated with it (Richter 2008);
- The complexity of the opaque OR system, which is preventing EU citizens from assessing their individual and respective country’s contribution to the EU budget and the connection between EU revenue and expenditure (Schratzzenstaller 2013, Fuest, Heinemann and Ungerer 2015);
- The application of various correction mechanisms, leading to an “unfair” distribution of the financial burden across MS;
- The fact that the OR system neither reflects nor directly supports central EU policies (Schratzzenstaller 2013, European Commission 2011a, HLGOR 2016) such as sustainable growth and development.

This lack of support of EU policies, which has been repeatedly stated also by the European Commission (e.g. European Commission 2011a) and the European Parliament (e.g. European Parliament 2017), is not only caused by the concrete design of the individual OR themselves, which at the moment have no direct allocative, distributive or steering effects. It is also due to the perception of the VAT-based own resource (making up for 12.4% of EU revenue in 2015) and the GNI-based own resource (69.1% of EU revenue in 2015) as pure national contributions. Such a perception induces MS to measure the benefits derived from the EU budget in terms of net financial contributions, i.e. as balance of national contributions and transfers received from the EU budget. Financing the EU budget primarily by national contributions furthers such a *juste retour* position by MS (Iozzo et al. 2008), demanding the maximisation of net benefits or at least the minimisation of net contributions from their respective country’s position, instead of the maximisation of an added value from an overall EU perspective. The dispute between “net contributors” and “net beneficiaries” also goes along with increasing tensions between MS regarding the size and structure of the EU budget (*inter alia* in the form of the so-called “net contributor debate”, see also HLGOR 2016) and exerts downward pressure on the EU’s budget volume (Haug et al. 2011). This has manifested itself in the most recent two MFFs, each one lower in

volume than the preceding one. Thus, the current structure of the EU system of OR can be seen as an obstacle to further European integration as well as an obstacle to fostering policies necessary for a sustainable economy and generating EU added value (European Commission 2011a).

1.2. GENERAL REFLECTIONS ON THE NATURE OF THE NEXT MFF

It is obvious that the general approach for the next MFF will also be dependent on which one of the five scenarios sketched by the European Commission's "White Paper on the Future of Europe" (European Commission 2017a) will be pursued eventually.

In its "Reflection paper on the future of EU finances" released mid-2017, the European Commission (2017c) very generally sketches out the implications of each of these five scenarios for the policy priorities guiding the expenditure structure, the EU budget's overall volume, the shares of expenditure under the various headings, and the revenue system. Only under the "Doing less together" scenario, which would imply a significantly lower overall volume of the EU budget, the structure of expenditure and revenue would remain broadly unchanged. All other scenarios would require structural shifts in EU expenditure in the European Commission's view, albeit to differing extents and, sometimes, in different directions; and they would also imply the need to introduce new OR, or at least other sources of revenue.

However, as also stressed by Haas and Rubio (2017b), considering the deficiencies in the current EU budget within the existing institutional and political framework of the EU, there are strong arguments in favour of an overhaul of the MFF with fundamental changes for the EU budget with a longer-term perspective, regardless of which of the future integration scenarios is envisaged. Even if questions about the speed, depth, direction, and concrete design of future EU integration, and questions about the future volume of the EU budget (which, of course, crucially depends on the future of the EU) are put aside; and even if its overall volume were to be held constant during the next MFF period as compared to the MFF 2014-2020, the structure of EU expenditure and revenue needs to be adjusted significantly. These shifts should be based on a comprehensive concept of sustainability, comprising economic dynamics, social inclusion, environmental sustainability, and cultural/institutional sustainability³.

In light of the long-term challenges the EU is facing, of possibly protracted Brexit negotiations, and the fact that the current discussions about the future of EU integration are still at a rather early stage, the duration of the next MFF requires careful consideration. On the one hand, a 5 + 5 year period, i.e. a ten-year period with a fundamental mid-term review, would guarantee long-term stability and predictability of expenditure. On the other hand, strong review clauses and a considerable extent of flexibility within the individual expenditure categories and, possibly, between them, would be required: particularly for the case where Member States do not succeed in agreeing on a fundamental overhaul of the EU budget by 2020. Otherwise, the window of opportunity for such a fundamental overhaul would open up again only at the end of the 2020s.

³ For such a comprehensive concept of sustainability, see Schratzenstaller et al. (2017).

Not least, possibilities to make receipt of EU funds contingent on compliance with fundamental principles of the rule of law, as reflected for example by the European Commission (2017c), should be explored in more detail.

2. STRUCTURE OF THE MFF

KEY FINDINGS

- The EU needs to provide those public goods that cannot be secured at Member State level alone as their benefits transgress national borders, thus creating European added value.
- Agricultural subsidies should be reduced significantly; and they should support environmental and employment goals and be targeted more at the less wealthy MS.
- Cohesion funds should be shifted from “richer” towards “poorer” MS and be coupled more strongly with climate and employment goals and a pro-active migration policy.
- Expenditure on research and innovation should be significantly increased, with a specific focus on environmentally and socially relevant aspects.
- Expenditure on cross-border energy and transport infrastructure should be significantly increased as part of a European decarbonisation strategy.
- Funds to substantially contribute to an internationally coordinated approach to the mitigation of the worldwide “refugee and migrant crisis” should be significantly increased.
- Funds for development assistance should be significantly increased to help the EU as a whole to reach internationally agreed ODA targets.

As a general principle, EU expenditure should only target policy areas in which MS’ uncoordinated actions would be insufficient due to free riding, coordination problems, and cross-border issues; or policy areas in which common European interests are at stake. Indeed, it is not an easy task to assess, measure, and quantify the European added value of specific policies (Heinemann 2016). One central criterion to identify European public goods with a European added value is whether action on the EU level results in a higher value compared to separate national actions; another is whether expenditure has a cross-border element (European Commission 2011b). The EU needs to provide those public goods that cannot be secured at MS level alone as their benefits transgress national borders, thus creating European added value.

European added value, with a focus on sustainability and, therefore, central EU objectives can be generated particularly by:

- Significantly reducing overall expenditure on agricultural policy; reinforcing the “greening” of direct payments to farmers within the “first pillar” of the CAP and the shift of agricultural expenditure to the “second pillar” supporting environmental and employment goals: in particular, strengthening the environmental sustainability of the CAP would contribute to climate goals, especially to a European decarbonisation strategy and would thus create

European added value. Moreover, agricultural subsidies should be targeted more towards the less wealthy MS, so that they also contribute to cohesion goals (Núñez Ferrer et al. 2016).

- Shifting cohesion funds from the “richer” to “poorer” MS and coupling them more strongly with climate and employment goals, as well as a pro-active migration and integration policy (e.g. education programmes): in particular the concentration of cohesion funds on the “poorer” MS could contribute to economic and social convergence within the EU, which would again produce European added value as the whole EU benefits from macroeconomic stability and growth in the cohesion countries⁴.
- Significantly increasing expenditure on research and innovation, with a specific focus on environmentally and socially relevant aspects (mission-oriented research): this not only includes the European research framework programme, but also investment in education, which should be expanded and support mobility of pupils, students, and (young) workers in particular.
- Significantly increasing expenditure on sustainability-oriented cross-border infrastructure, with a specific focus on Trans-European Networks (TENs), as part of a European decarbonisation strategy: trans-border railway networks, which are associated with significantly lower carbon emissions and other environmental costs compared to other transport modes, should be strengthened⁵. Another focus should be on cross-border clean energy networks.
- Significantly increasing funds to make a substantial EU contribution towards the goals of an internationally coordinated approach to the mitigation of the world-wide “refugee and migration crisis” as defined at the Summit for Refugees and Migrants hosted by the annual UN General Assembly in September 2016 in New York⁶: to allocate more funds to humanitarian assistance; to set up functioning resettlement programmes or alternative legal structures to encourage countries to admit more refugees; and to implement integration policies enabling refugees to education and legal work.
- Significantly increasing funds for development assistance to help the EU, as a whole, reach internationally agreed ODA targets.

These shifts in EU expenditure towards European added value and stronger sustainability orientation should be pursued regardless of the scenario envisaged for the future of European integration. The current budget volume of about 1% of GNI leaves considerable space for significant expenditure shifts, given the high shares of agricultural subsidies and cohesion funds. A combination of expenditure cuts (CAP) allowing an increase of overall spending in the above-mentioned categories with a sustainability oriented shift of priorities within each spending category can be expected to significantly increase the added value of EU spending. Scenarios implying deeper integration of all, or a group of, MS would have

⁴ Núñez Ferrer and Katarivas (2014) show that cohesion policy benefits all EU MS’ economies.

⁵ The determination and exact quantification of the external costs for different transport modes in general, and of their environmental costs in particular, is a complex and difficult task. However, there seems to be a consensus in the literature that environmental costs of air traffic and especially its contribution to climate change are by far the largest, particularly compared to rail transport (e.g. CE Delft et al. 2011).

⁶ <https://refugeesmigrants.un.org/summit>.

more fundamental implications for the composition and for the level of EU expenditure, as substantially deepening European integration would obviously require a higher budget volume.

To reflect adequately the suggested structural shifts and the new priorities required for an effective contribution of EU expenditure to EU objectives, the main headings should be adapted accordingly. The next MFF could comprise the following headings:

- Sustainable growth and development in the EU
 - Research, innovation and education
 - Low-carbon cross-border infrastructure (Trans-European networks in energy and transport)
 - Regional cohesion
 - Environmentally sustainable agricultural policy and natural resources
- Migration and development assistance
- Internal security, border security and defence
- Administration

As a reaction to the multiple crises occurring in the past few years, several instruments and facilities have been introduced inside and outside the MFF to enhance the flexibility of the EU to be able to cope with unexpected events (e.g. the recent “refugee and migrant crisis”). Considering the already existing and emerging fundamental long-term challenges ahead, and given that there is a certain probability of new crises to arise in the near future, it seems advisable to provide for sizeable funds for unexpected events within the next MFF (Núñez Ferrer et al. 2016).

3. OWN RESOURCES

KEY FINDINGS

- Tax-based OR should replace part of current OR (in particular the VAT-based OR) within a fiscally neutral approach and should be complemented by a GNI-based OR.
- Tax-based OR have the potential to reduce sustainability gaps within MS’ tax regimes and alleviate the *juste retour* problem.
- Obvious candidates are taxes, which cannot be enforced effectively at the national level due to tax competition, and taxes on cross-border externalities (e.g. carbon emissions).
- Candidates are an EU-wide carbon-based flight ticket tax, a net wealth tax, a carbon border adjustment tax, a financial transactions tax, or a common (consolidated) corporate tax base.
- A basket of tax-based OR is preferable to introducing one single tax-based OR.
- Tax-based OR would not require genuine taxation powers of the EU, but revenue could be transferred from MS to the EU budget based on a remittance system.

Along with substantial reforms within EU expenditure, the EU system of OR needs to be overhauled fundamentally. The European Commission, as well as the European Parliament, have been in favour of substituting part of current OR with tax-based OR; a position supported by the results of the High Level Group on Own Resources (HLGOR) (2016)⁷. However, it does not go far enough to discuss the potential of tax-based OR only as being a tool for further European integration. In addition, they have the potential to reduce economic, social, environmental, and institutional sustainability gaps within MS' tax regimes.

The introduction of sustainability-oriented tax-based OR, partially substituting MS' national contributions, can strengthen the contribution of the EU system of OR to central EU policies (Schratzenstaller 2017a). In all MS, a considerable and (at least for the EU15) increasing share of overall tax revenue stem from taxes on labour (Eurostat 2016). At the same time, the weight of corrective Pigovian taxes, i.e. environmental taxes and taxes on alcohol and tobacco consumption is decreasing. Taxes on the financial sector, which besides fairness aspects can also be motivated by Pigovian considerations (Keen 2010), still play a rather limited role in the EU (Cannas et al. 2014, Hemmelgarn et al. 2016). While the share of property taxes in overall tax revenue has risen slightly over the last decade, their contribution to overall tax revenue has remained rather limited. Together with the declining trend in the shares of taxes on capital and the increasing weight of VAT and social security contributions, this suggests that the redistributive power of taxation and thus its contribution to social inclusion has weakened over time.

Within the EU company tax competition, is another sustainability-relevant issue. Company tax competition in the EU manifests itself in the decrease of statutory and effective corporate tax rates (Leibrecht and Hochgatterer 2012). Moreover, recent empirical results suggest that profit shifting is indeed taking place on a large scale. Tax avoidance activities by multinational firms lead to sizeable company tax losses for EU countries (Fuest et al. 2013).

Introducing sustainability-oriented tax-based OR to substitute national contributions would enable MS to cut more harmful taxes at the national level, in particular the high taxes on labour, and would thus allow a fiscally neutral, however sustainability-enhancing tax shift.

Obvious candidates for sustainability-oriented EU taxes are those that cannot be enforced effectively at the national level due to tax competition based on highly mobile tax bases and/or tax subjects. The case for assigning Pigovian taxes to the EU level is strengthened further if tax rates, due to cross-border externalities which are not taken into account by national governments, are set at sub-optimal levels (Jones, Keen and Strand 2012). In addition, unilateral tax measures aimed at reducing cross-border externalities (i.e. externalities caused by emitting greenhouse gases) may alleviate the pressure on other countries to implement unilateral tax measures themselves, as they can act as free-riders (Auerswald, Konrad and Thum 2011).

In some cases, tax revenue is not clearly attributable to individual MS, because it is levied on tax bases with a cross-border nature. Following the reasoning of Keen, Parry and Strand (2012), it can be argued

⁷ See for an overview of existing reform proposals European Parliament (2017).

that the revenue from those taxes levied on tax bases characterised by international spill-overs should be used to finance a supranational budget as it can hardly be assigned to specific countries.

Candidates for sustainability-oriented tax-based OR are an EU-wide carbon-based flight ticket tax (Krenek and Schratzenstaller 2017a), a carbon border adjustment tax (Krenek, Schratzenstaller and Sommer 2017), a fuel tax (Nerudová, Dobranschi and Solilová 2017), a net wealth tax (Krenek and Schratzenstaller 2017b), a financial transactions tax (Solilová, Nerudová and Dobranschi 2017), or a common (consolidated) corporate tax base (C(C)CTB) (Nerudová, Solilová and Dobranschi 2016)⁸. Most of these options for tax-based OR are also addressed in the Final Report of the High Level Group on Own Resources (HLGOR 2016). Following the HLGOR (2016), a basket of tax-based OR is preferable to introducing one single tax-based own resource: thus, differing country-specific incidence of individual taxes would, to a certain extent, cancel out making the need for correction provisions less pressing. Moreover revenue would be made more stable.

The implementation of tax-based OR does not necessarily require individual genuine taxation powers, i.e. full legislative and revenue authority for the EU, and is, therefore, also compatible with the current institutional set-up (i.e. the “Carrying on” scenario). Under this scenario, tax-based OR could be introduced based on a kind of remittance system, with MS’ tax administrations collecting revenue and transferring it (partially) to the EU budget (Solilová, Nerudová and Dobranschi 2017). For the case of a basket of several tax-based OR, a uniform call up rate, as a percentage of MS’ GNI, could be fixed. This call up rate could be applied to MS’ overall revenue from tax-based own EU resources to determine the amount to be remitted to the EU budget. The remaining revenue not transferred to the EU budget would go into national budgets. Together with savings in MS’ direct contributions to the EU budget replaced by tax-based OR, this revenue could be used – in a fiscally neutral way – to cut less sustainability-oriented taxes levied at the national level, in particular the high taxes on labour.

Such a pragmatic approach would not restrict national tax sovereignty and could thus be more acceptable to (the overwhelming majority of) MS’ governments and parliaments which are currently reluctant to give up some of their taxation powers.

Sustainability-oriented EU taxes would not only help to close the existing sustainability gaps in EU taxation. Due to their positive sustainability-promoting effects, they would probably be socially and politically more acceptable than other tax-based OR which are pure revenue-raising instruments lacking any desirable steering effects and may even be perceived as unfair, as for example the VAT-based own resource suggested by Cipriani (2014).

Moreover, the sustainability-oriented tax-based OR suggested above have the potential to alleviate the *juste retour* problem: by loosening the direct link between national transfers to, and payments received from, the EU budget as their revenue can hardly be assigned to individual MS and because of their “additionality”, as they could be enforced only insufficiently, or not at all, at the national level. This additionality has two further advantages: First, there would be no, or only very few, MS levying the respective tax already at the national level, so that no significant resistance by national governments

⁸ These candidates for sustainability-oriented tax-based own resources are currently being analysed in the Horizon 2020 EU project „FairTax“ (www.fair-tax.eu).

against assigning the revenue to the EU level would have to be expected, as well as demands for compensation for the revenue foregone⁹. Secondly, issues of vertical tax competition and of tax base co-occupation through exploiting certain tax bases simultaneously at the level of MS and the EU (Kotsogiannis 2016), respectively, would be of negligible relevance.

Fears expressed from a political economy perspective that tax coordination would be equivalent to forming a tax cartel of national governments at the expense of citizens (Bernholz et al. 2004), appear exaggerated: there is well-documented evidence on under-taxation of the areas addressed by our concept of sustainability-oriented taxation (see, e.g., Cannas et al. 2014 for the financial sector, European Commission 2015 for the profits of multinational enterprises, or Keen, Parry and Strand 2013 for international aviation and shipping) which suggests that the beneficial effects of tax coordination can be expected to dominate potential welfare-enhancing effects of tax competition¹⁰. A focus on such areas, where under-taxation is obvious, may mitigate another objection to introducing certain sustainability-oriented tax-based OR: generally tax policy decisions, with respect to the sustainability triangle, frequently involve decisions on important trade-offs, on which voters' preferences may be very different across EU countries¹¹. Trade-offs in the areas of under-taxation mentioned above, however, should be less pronounced.

Of course implementing sustainability-oriented tax-based OR whose revenue is (partially) dedicated to finance the EU budget requires unanimity among MS. An introduction, based on enhanced cooperation, as the alternative coordination mechanisms in the EU, requiring a "coalition of the willing" of at least nine EU MS (as has been pursued since 2012 for the financial transactions tax) and with revenue accruing to national budgets (and corresponding to a "Some do more" scenario), would clearly limit the effectiveness of an approach aiming at a sustainability-oriented re-design of the EU system of OR. On the other hand, a certain degree of differentiation and a step-wise introduction of tax-based OR, departing from a core group of MS willing to go forward, may open the way towards universal implementation in the EU (HLGOR 2016). Certainly, the worldwide introduction of sustainability-oriented taxes on tax bases with a more or less global dimension would be preferable to EU-wide solutions. Nonetheless, substantial corrective effects can be expected already by a coordinated implementation within a group of countries only¹². In any case, such limited approaches could serve as pilot phases demonstrating that the coordinated introduction of specific sustainability-oriented taxes, as well as internationally coordinated financing schemes, are feasible; and that they have the potential to shift voter preferences in originally non-cooperating countries towards sustainability-oriented OR by convincing them of their benefits. Their introduction may thus not only constitute a first step towards a longer-term sustainability-oriented reform of the EU's financing system, but even towards

⁹ Obvious exceptions are the corporate income tax and a fuel tax, whose partial transfer to the EU might inspire demands for compensation by MS.

¹⁰ The Political Economy literature argues that competition among governments for internationally mobile tax bases is beneficial because it generates strong incentives to reduce government inefficiencies and would thus help to "tame the Leviathan" (e.g. Brennan and Buchanan 1980; Sinn 1992).

¹¹ For a long-term study of the persisting cultural and institutional heterogeneity across Europe see Alesina et al. (2017).

¹² See Keen, Parry and Strand (2012) for taxes on international aviation and shipping.

the implementation of European/international financing arrangements of European/international public goods which are urgently needed in face of pressing global challenges.

Tax-based OR should replace part of the current OR. Primarily, the VAT-based OR (12.4% of overall revenue in 2015) should be eliminated, as its concrete design is rather complicated and adds to the complexity of the current revenue system (Fuest, Heinemann and Ungerer 2015). The size of the future share of tax-based OR in overall EU revenue of course will depend on the integration scenario pursued. However, as noted above, considering the existing sustainability gaps in MS' tax systems and in the EU system of OR, the next MFF should, in any case, include revenue from sustainability-oriented tax-based OR.

Also under those scenarios envisaging deeper integration of a group of, or all EU MS, tax-based OR will have to be complemented by revenue from a GNI-based resource: as the EU is not allowed to incur debt, any shortfalls from tax-based OR have to be compensated by a residual OR (Núñez Ferrer et al. 2016).

4. CONCLUSIONS AND OUTLOOK

A comprehensive sustainability-orientation of the EU budget could be one key element to contribute to the targets of the Europe 2020 strategy, to the Sustainable Development Goals, and to the Paris Agreement. It would also increase the European added value created by EU expenditure. Fundamentally re-structuring EU expenditure towards European added value is also a key prerequisite for the implementation of tax-based OR (HLGOR 2016).

The momentum created by the current reflections on fundamental flaws in the E(M)U architecture (European Commission 2017b) as well as on the future of EU finances (European Commission 2017c) could help to push such radical reforms in the EU budget forward. Moreover, as stressed by the HLGOR (2016), the Brexit shock can be seen as an opportunity to completely reform the structure of the EU's expenditure and revenue. The imminent Brexit can be expected to facilitate future-oriented reforms of the EU budget directly via various channels (Schatzenstaller 2017b). First, the United Kingdom has always been one of the fiercest proponents of the net contributor position, focusing mainly on the difference between payments into the EU budget and transfers received out of it instead of the European added value of EU expenditure, and the fact that net balances do not necessarily reflect the true benefit of national contributions to the EU budget. Secondly, and this is related to the first point, the rebate for the United Kingdom will no longer be necessary, so that there is a good chance that the accompanying correction mechanisms (the rebate from the rebate for several net contributing countries) can be abolished at last (HLGOR 2016). Thirdly, because the United Kingdom is one of the most vehement opponents of tax coordination on the EU level. Therefore, its exit from the EU should make the introduction of tax-based OR (for example the financial transactions tax which is strictly rejected by the United Kingdom) less controversial among the remaining EU MS. In addition, the Brexit may provide indirect support to fundamental reforms in the MFF by increasing awareness at Member State level that the EU budget needs to deliver more added value for European citizens to prevent further acceleration of exit movements in other EU MS. Thus, openness and willingness of EU MS to

agree to expenditure reforms towards European added value as well as the acceptance of reforms on the revenue side, in particular in the form of tax-based OR, and especially those that have some integrative power because they are appealing to many EU citizens (e.g. a financial transactions tax), may be enhanced. At the same time, the Brexit bears the danger of exacerbating the net contributor debate at least in the short run, which may lead to demands for cuts in the overall volume of the EU budget and/or new rebates for net contributors.

Ultimately, it will depend on how EU MS decide to adjust to the revenue shortfall caused by the Brexit: by increasing national contributions or introducing other additional revenue sources; by cutting expenditure; or by some combination of these two options (Haas and Rubio 2017a). Substituting a major share of national contributions by sustainability-oriented tax-based OR may act as a catalyst to secure net contributors' agreement to maintain the current spending level in exchange for a far-reaching reform of EU expenditure to enhance European added value. Therefore, one crucial success factor for a future-oriented reform of EU finances is to understand the need for package solutions, as stressed by Núñez Ferrer et al. (2016), comprising the expenditure as well as the revenue side of the EU budget. An obvious example for such a package deal is the concentration of cohesion funds on "poorer" MS, which currently in the majority strongly object to tax coordination efforts as they regard the option of tax cuts as one of the few instruments available to them to secure their competitiveness, in exchange for their agreement to the EU-wide introduction of tax-based OR on a harmonised basis. Another package deal may include the introduction of carbon levies and specific support measures to further decarbonisation for particularly strongly affected countries (Núñez Ferrer et al. 2016), possibly within agricultural or cohesion funds or expenditure on Trans-European networks.

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The EU budget is facing numerous long-term challenges, which are not adequately addressed, neither on the expenditure nor on the revenue side. Regardless of the future EU integration scenario, a fundamental overhaul of the MFF is required. EU expenditure should provide more European added value. Tax-based own resources partially replacing current own resources have the potential to reduce sustainability gaps within Member States' tax regimes as well as to alleviate the *juste retour* problem.

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