BRIEFING

A recipe for a sustainable and legitimate new EU/EA fiscal instrument?

This note sets out proposals to find a sustainable and limited new EU fiscal instrument allowing the swift financing of common projects agreed by the Member States. It would involve a Treaty change (under the simplified procedure) and agreeing on the modalities of a more effective and fairer tax base for EU companies benefitting most of the internal market, EU trade policy and the euro exchange rate and use such proceeds to finance EU projects, such as the proposed new EU recovery fund. This note is provided as food for thought for EU policy makers in the spirit to broaden the debate to balance short term needs and long term interest of the EU as a whole.

Since the Euro crisis, multiple and conflicting views on how to best fight major risks to the economic and financial stability of the EU and notably of the Euro Area (EA) have been put forward. Heated debates took place at various stages and levels (including national parliaments). Governments have struggled to find common ground due to national positions and perceptions of their voters on what is, or is not, fair.

Finding ways to finance common projects or deal with emergencies without creating common liabilities might need to be discussed openly, as well as which solutions could best match national interests and those of the EU as a whole.

Currently, the EU is facing one of such decisive moments: financing for the corona-related expenses from the Union budget has proven very difficult. Notwithstanding, the Commission is testing all available avenues (SURE being the latest one). Many Member States fear to face financial constrains due to the economic and social consequences of the pandemic.

The Eurogroup outlined on 9 April 2020 a compromise package of measures to support citizens, companies and governments struggling with the economic, financial and social consequences of the pandemic. Many of these measures involve leveraging on current EU instruments and aim to increase liquidity facilities (i.e. loans to be paid back by the debtor); in some cases, the details of the instruments still need to be clarified. Ministers also agreed *to explore the setting up of a temporary Recovery Fund to ensure a robust European economic recovery in all Member States*[1]. No compromise was yet found on the nature of this new common funding instrument.

One recipe for a fresh start would be to allow the EU to issue a limited amount of debt certificates beyond the current limits and increase the basket of EU own revenues. This would also avoid governments to be directly or indirectly liable for each others' debt (thus, avoiding the debate on joint liability instruments). We do recognise that these proposals rely on two politically sensitive elements, and therefore such proposals could be framed as follows:

Economic Governance Support Unit (EGOV)
Authors: Kajus Hagelstam, Cristina Dias, Marcel Magnus, Alice Zoppè,
Jost Angerer, Andrea Di Filippo, Saverio Lenzi
Directorate-General for Internal Policies
PE 645.720 - 14 April 2020

- Allowing the EU to run a budget deficit to a predefined level and thus creating additional financial space (requiring a targeted Treaty change); and

- Agreeing on a limited new own revenue source based on a harmonised tax base for EU companies (under the current Treaty).

Allowing the EU to run a deficit would require an amendment to the TFEU, notably to Article 310[2]. Such a deficit would be under the control of Member States and would be capped in the Treaty. Member States would allow the EU to issue bonds up to the amount of the agreed Multiannual Financial Framework (MFF) (i.e. if the MFF would be around 1,2 trillion euro, EU would be allowed to have outstanding debt up to this amount)[3]. Today, the European Commission already operates , on behalf of the EU, three loan programmes funded in the capital markets (total amount around €52 billion) and therefore has some experience in issuing bonds[4]. With political will, this amendment could be done rather swiftly, through the simplified procedure[5]. Last time the TFEU was amended was in the conjunction with the establishment of the ESM (this time it could be done in parallel to the envisaged ESM Treaty change).

As to the second element, Member States could agree on the modalities of a new own revenue source for the EU that would be progressively implemented (e.g. after a transition period of two years). This could be a corporate tax allocated to the EU and based on the Common Consolidated Corporate Tax base (CCCTB)[6]. It would imply that a share of the national revenues under the CCCTB would be transferred to the EU level[7]. A possible proposal could be as follows: all EU companies above a certain size (beyond SME[8]) would pay, say 1 or 2 percentage points of their profit to the EU budget (and earmarked in national taxation laws as a revenue for the EU)[9].

This would mean that companies benefitting most of EU policies, such as the internal market, trade policy and the euro exchange rate (notably for companies in the EA) would pay a share of their profit to the EU, to benefit the EU as a whole and all its Member States.

The idea of using a corporate tax to finance EU projects was already put forward in the “Monti Report“:

> *“A new own resource based on a common consolidated corporate tax base would score well on many crucial criteria identified for own resources, in particular equity, efficiency, democratic accountability and European added value, on the condition that the tax base is actually consolidated and sufficiently large to yield sufficient revenue. As it is currently envisaged, the CCCTB is limited for the purpose of own resources because it is built on the voluntary registering of companies, except for those with annual consolidated group revenue of more than EUR 750 million, for which registering will be mandatory. It remains to be seen if this high mandatory threshold would suffice to produce significant revenues or if this aspect would need to be revisited if the CCCTB is envisaged as a future source of revenue for the EU budget”* (Future Financing of the EU: Final report and recommendations of the High Level Group on Own Resources December 2016).

In the short term (until the CCCTB would be in place), Member States would be (contractually) obliged to transfer an amount corresponding to 1-2 percentage point of the profits of their corporations to the new EU fund. In the case of 1 percentage point, this could amount to around €20 billion per year (based on 2017 figures for EU-27): Germany (€5.3 billion) and Netherlands (€2.7 billion) having the largets contributions and Slovenia (€0.04 billion) and Estonia (€0.05 billion) having the lowest (see Annex).

With this new revenue stream of permanent nature (first on contractual basis and later based on the CCCTB, acting as a sort of guarantee) the EU could aim to issue bonds as mentioned above up to a predefined limit (namely up to the size of the MFF of around €1,2 trillion), using the revenues to pay the coupons and, over time, repay the principal. The financial exposures thus created would be limited by design: the amount of the total outstanding bond stock would be capped and once the maximum outstanding debt level is reached, new debt issuance (beyond rolling over of old debt stock) would only be possible up to the level of the annual revenue stream.

New resources obtained in this manner could finance common EU/EA priorities, such as the recovery fund being discussed by the Eurogroup. These EU resources could provide emergency assistance (i.e. in the case of major economic shocks, natural disasters, and security and health risks). Such resources could only be used in accordance with common priorities agreed by the EU Heads of State. The available support instruments would include grants and loans, conditional on the use of funds in accordance with the agreed purpose (i.e. the conditions for getting the grant or the loan). Having the possibility to use grants could enable EU to be more effective and give targeted assistance in extraordinary circumstances.

Obviously, it would be beneficial if all EU Member States would take part from the beginning. As second best option, it would be a solution for a specific Euro Area Fund (i.e. via enhanced cooperation).

Tthe main objective is to establish, in a rather short time, a new EU fiscal instrument based on legal commitments of future regular revenue streams collected from EU companies[10]. However, It is up to the reader to judge on acceptability, feasibility and simplicity of this proposal as an effective EU emergency and recovery instrument.

ANNEX: Estimation of country specific contributions based on corporate profit or income in 2017

Member State	A) Implicit tax rate on corporate income *	B) Corporate income tax revenues in billion	C) Estimation of Corporate profit or income in billion (C = B/A)	D) Estimated 1 % contribution in billion (D = 1/100 * C)	E) Share of total corporate tax revenues (E = D/B)
Belgium	24.1 %	18.1	75.1	0.75	4.1 %
Bulgaria	11.2 %	1.2	10.7	0.11	9.2 %
Czech	20.2 %	6.7	33.2	0.33	5%
Denmark	18.2 %	8.9	48.9	0.49	5.5%
Germany	16.8 %	88.7	528.0	5.28	6 %
Estonia	7.4 %	0.4	5.4	0.05	12.5%
Ireland	8.6 %	8.3	96.5	0.96	11.6%
Greece	15.1 %	3.5	23.2	0.23	6.6%
Spain	14.9 %	27.1	181.9	1.82	6.7%
France	36.4 %	66.8	183.5	1.83	2.7 %
Croatia	-	1.1	-	-	
Italy	19.5 %	35.6	182.6	1.82	5.1%
Cyprus	8.6 %	1.1	12.8	0.13	11.8%
Latvia	9.2 %	0.4	4.3	0.04	10.0%
Lithuania	5.7 %	0.6	10.5	0.10	16.7%
Luxembourg	8.5 %	2.9	34.1	0.34	11.7%
Hungary	12.1 %	2.4	19.8	0.2	8.3%
Malta	-	0.7	-	-	
Netherlands	8.9 %	24.2	271.9	2.72	11.2 %
Austria	17.2 %	9.4	54.7	0.55	5.9%
Poland	12.1 %	9.0	74.4	0.74	8.2%
Portugal	25.0 %	6.3	25.2	0.25	4.0%
Romania	11.3 %	3.8	33.6	0.34	8.9%
Slovenia	18.3 %	0.8	4.4	0.04	5.0%
Slovakia	29.3 %	2.9	9.9	0.10	3.4%
Finland	17.7 %	6.1	34.5	0.34	5.6%
Sweden	20.9 %	13.9	66.5	0.66	4.7%
Total (EU-27)	-	351	2025.6	**20.26**	5.8%

Source: Taxation Trends in the European Union data for EU Member States, Iceland and Norway, 2019 edition, European Commission https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_trends_report_2019.pdf

* Table 5: Implicit tax rate on corporate income (traditional version), 2000-2017, page 36.

End Notes

[1] "*In this context, we also agreed to work on a Recovery Fund to prepare and support the recovery, providing funding through the EU budget to programmes designed to kick-start the economy in line with European priorities and ensuring EU solidarity with the most affected member states. Such a fund would be temporary, targeted and commensurate with the extraordinary costs of the current crisis and help spread them over time through appropriate financing. Subject to guidance from Leaders, discussions on the legal and practical aspects of such a fund, including its relation to the EU budget, its sources of financing and on innovative financial instruments, consistent with EU Treaties, will prepare the ground for a decision*."

[2] The article in the Treaty that says the budget needs to be balanced is 310/1 3 subpara: "*The revenue and expenditure shown in the budget shall be in balance*." and 310/4: "*With a view to maintaining budgetary discipline, the Union shall not adopt any act which is likely to have appreciable implications for the budget without providing an assurance that the expenditure arising from such an act is capable of being financed within the limit of the Union's own resources and in compliance with the multiannual financial framework referred to in Article 312*".

[3] The level of commitments in the Commission proposal for the next MFF (2020-2027) translates into EUR 1,246 billion in payments, corresponding to 1.08% of the EU-27 gross national income.

[4] European Commission: EU Investor presentation, January 2020: https://ec.europa.eu/info/sites/info/files/economy-finance/eu_investor_presentation_en.pdf

[5] The European Council acts by unanimity having consulted the Commission, the European Parliament, and the European Central Bank if the amendment concerns monetary matters. Amendments to the Treaties only enter into force if they have been ratified by all EU countries. The competences of the EU, however, may not be extended by means of a simplified revision procedure. To fulfil this latter condition one may note that the right to issue bonds would be limited to a predefined level and the Member States (in the Council) would have the final say on using this tool i.e. if they would like to narrow down the possibility for the EU to issue new bonds the future, they would agree on a lower level in the MFF (e.g. if the MFF would be reduced to the half then the total amount of outstanding EU bonds would need to be reduced progressively to fulfil the new limit set). This would mean that no new EU level powers (e.g. no discretion) would be granted and the Member States would remain the final decision makers on the size of this new financing tool.

[6] https://ec.europa.eu/taxation_customs/business/company-tax/common-consolidated-corporate-tax-base-ccctb_en

[7] The Commission's MFF proposal (2020-2027) included already the idea of a stronger link between the financing of the budget and the Union's policies by introducing a basket of new Own Resources as follows:

- Emissions Trading System: the European Emissions Trading System is a key tool of EU action to reduce greenhouse gas emissions cost effectively and has a direct link with the functioning of the Single Market. The Commission proposes to allocate a share of 20% of the Emissions Trading System revenues to the EU budget, while protecting the correction mechanisms already embedded in the system.
- The relaunched Common Consolidated Corporate Tax Base, to be phased in once the necessary legislation has been adopted. This will link the financing of the EU budget directly to the benefits enjoyed by companies operating in the Single Market.
- A national contribution calculated on the amount of non-recycled plastic packaging waste. This will create an incentive for Member States to reduce packaging waste and stimulate Europe's transition towards a circular economy by implementing the European plastics strategy.

On the basis of the Commission's proposals, the new Own Resources could contribute on average EUR 22 billion per year corresponding to about 12% of total EU budget revenue.

[8] 1. The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million. Commission Recommendation of 6 May 2003 C(2003) 1422).

[9] Introducing a genuine EU level tax (levied and collected centrally) would not be possible via a simplified EU Treaty change.

[10] Olivier Blanchard, Jean Pisani-Ferry on 10 April 2020 argued that ECB monetary financing is an acceptable tool, while finding other budgetary solutions would be preferable: "*In the specific case of the euro area, the ECB's bond-buying purchase programme can evidently serve as a channel for mutualising the cost of the crisis. This is in part by default: we see good reasons why part of the burden of fighting the pandemic should be mutualised among EU members, but it would be more appropriate to do so in a more transparent way through explicit budgetary and financial channels.*"

Disclaimer and copyright. The opinions expressed in this document are the sole responsibility of the authors and do not necessarily represent the official position of the European Parliament. Reproduction and translation for non-commercial purposes are authorised, provided the source is acknowledged and the European Parliament is given prior notice and sent a copy. © European Union, 2020.

Contact: egov@ep.europa.eu

This document is available on the internet at: www.europarl.europa.eu/supporting-analyses