

SPECIAL REPORT No 6/98
concerning the Court's assessment of the system of resources based on VAT and GNP together
with the Commission's replies

(submitted pursuant to the second subparagraph of Article 188c(4) of the EC Treaty)

(98/C 241/02)

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1. INTRODUCTION

1.1. This report examines the development, the workings and the limitations of the Community budget's two main sources of funds, to wit the VAT and GNP resources, which account for approximately 80 % of the Community's revenue i. e. 61 000 Mio ECU in 1997 ⁽¹⁾. The reader is reminded that the entire system of own resources has been examined once before, in 1993 ⁽²⁾. Subsequent Annual Reports have also made observations on the traditional own resources, in addition to those set out in the 1993 report.

1.2. Various Court Annual Reports have also looked at several aspects of the VAT and GNP resources. In respect of the VAT resource, these aspects included, in particular, the disparity between Member States in respect of the

data used for the calculation of the Weighted Average Rate (a fundamental element of the assessment base) and the various adjustments and compensations. Regarding the GNP resource, the Court's previous comments looked, in particular, at the methods and procedures used for making forecasts, the quality of the national accounts and the need for measuring instruments.

1.3. Given the scale of the phenomenon, this report also looks at the consequences for the VAT and GNP resources of the loss of tax income.

2. FINANCING THE COMMUNITY BUDGET

The background to the system for financing the Community

2.1. The Treaty of Paris of 18 April 1951 ⁽³⁾, which set up the European Coal and Steel Community (ECSC),

⁽¹⁾ Data on budgetary implementation are given in *Annexes Nos I and II*.

⁽²⁾ Opinion No 8/93 of the Court of Auditors on an assessment of the system of own resources introduced in 1988 in the light of the conclusions of the Edinburgh European Council (document not published in the Official Journal). This Opinion was drawn up at the request of the European Parliament.

⁽³⁾ The main stages in the development of the system of financing the Communities are given in *Annex No IV*.

provided that the latter would be financed from levies based on coal and steel production.

2.2. In addition to these levies, which might rightly be defined as the first Community tax, there was also interest received on own funds, investments, reserves and other revenue.

2.3. In 1957, with the creation of the European Economic Community and the European Atomic Energy Community, the Treaties had provided for national contributions, with the option of replacing these with own resources. These contributions were established as percentages of budgetary expenditure, the costs being shared out among the Member States according to various cost-sharing formulae, depending on whether the expenditure being financed was administrative or operational (at the time, primarily expenditure on research and the Social Fund).

2.4. This system remained practically unaltered until the adoption of the Council Decision of 21 April 1970⁽⁴⁾, concerning the replacement of the Member States' financial contributions with Community own resources.

2.5. The aim of this Decision was for the Community budget to be funded entirely from own resources, i. e. agricultural levies, contributions based on the production of sugar and isoglucose and customs duties levied at the Community's external borders, as well as a percentage of the base of the VAT collected by the Member States. In 1988, in order to reduce the relative share of the VAT resource and, at the same time, increase revenue, a fourth resource, based on GNP, was created. Broadly speaking, this system is still in force.

The main characteristics of the VAT and GNP resources

2.6. The present system is governed by Council Decision No 94/728/EC, Euratom of 31 October 1994⁽⁵⁾. The budget is partly financed by resources that are paid over by taxpayers (agricultural levies, sugar levies and customs duties).

2.7. The VAT and GNP resources constitute transfers of revenue from the Member States to the budget of the European Union. In *Annex No III*, the data in Table No I show that the VAT and GNP resources represent, from one Member State to another, a variable percentage of

tax revenue. Tables Nos II and III compare the VAT and GNP resources in terms of population and GNP.

The VAT resource

2.8. The assessment base for the VAT resource is calculated on the basis of net revenue collected for this purpose by the Member States during a given year. This income is divided by a rate, known as the Weighted Average Rate, which, for each Member State, represents the weighted average of the various rates applicable to all transactions subject to non-deductible VAT. Final household consumption constitutes the lion's share of these transactions, which are taken from the national statistical accounts.

2.9. Because of the different ways that the common VAT system is applied in the various Member States, in particular in order to take into account the various exemptions and exceptions, adjustments are carried out so as to standardise the final VAT resource base, as required by the Regulation.

The GNP resource

2.10. The GNP resource represents a percentage of Gross National Product at market prices, established in accordance with Council Directive No 89/130/EEC, Euratom of 13 February 1989⁽⁶⁾. The function of this resource is to balance the Community budget: it is only called up in order to make up the difference between planned expenditure and the other resources available (agricultural levies, sugar and isoglucose levies, customs duties, VAT resources and other revenue).

Determining and monitoring the VAT and GNP assessment bases

2.11. These two resources rely on data that are drawn up and forwarded by the Member States, initially on the basis of an estimate and then on the basis of the actual figures (subject, however, to possible subsequent adjustments⁽⁷⁾). The relevant provisions⁽⁸⁾ state that the Member States and the Commission are responsible for

⁽⁴⁾ Council Decision No 70/243/ECSC, EEC, Euratom of 21 April 1970 (OJ L 94, 28.4.1970, p. 19).

⁽⁵⁾ OJ L 293, 12.11.1994, p. 9.

⁽⁶⁾ OJ L 49, 21.2.1989, p. 26.

⁽⁷⁾ For financial year n, the estimated data are established at the start of the year n-1. The actual data are forwarded in the second half of the year n+1.

⁽⁸⁾ For the VAT resource: Council Regulation No 1553/89 of 29 May 1989 (OJ L 155, 7.6.1989, p.9). For the GNP resource: Council Directive No 89/130/EEC, Euratom of 13 February 1989 (OJ L 49, 21.2.1989, p. 26).

determining complete and uniform tax bases for assessing the VAT and GNP resources.

2.12. The data concerning these bases are inspected by the Commission, which is required to ensure uniform compliance by all the Member States with the relevant provisions on the calculation of tax bases.

3. THE LIMITATIONS AND DISTORTIONS OF THE CURRENT SYSTEM

3.1. By virtue, in particular, of the provisions of Articles 199 and 201 of the EC treaty, the budget must be balanced. It must in fact be wholly financed with the resources provided for this purpose. The only existing limitation is a ceiling of 1,27 % of GNP for all the resources ⁽⁹⁾.

3.2. Whilst, in consequence, the necessary resources are guaranteed, on the other hand, the design and the practical running of the system are subject to a number of constraints, which are discussed below.

Virtual own resources

3.3. According to the Commission 'the methods used to finance the Community budget illustrate the political development of the Community. Thus, in the beginning, the Community was financed by financial contributions from the Member States based on fixed percentages (Article 200 of the EC Treaty)' ⁽¹⁰⁾. This system was to be replaced by own resources (Article 201 of the EC Treaty). These own resources therefore took the form of taxes that were levied directly on natural and legal persons within the Community. They were independent of the decisions of the Member States and there was an automatic link between the Community and its source of revenue, i.e. all economic transactions liable to Community taxation.

3.4. The original plan of making the VAT resource a tax based directly on consumption, or, at least, on taxpayers'

declarations, was subsequently abandoned ⁽¹¹⁾ as a result, in particular, of the differing ways the VAT legislation is applied in the Member States. The practical procedures for calculating this resource ⁽¹²⁾ confirm the fact that it is a national contribution ⁽¹³⁾. This resource derives from a tax that is not borne by taxpayers; instead it represents a debt on the part of the Member States.

3.5. Contrary to the Commission's 1988 statement, even though the VAT resource is based on the first tax to be harmonised at a European level, it may be doubted that it has had 'an undoubted political and psychological impact' ⁽¹⁴⁾. In fact, its link to fiscal reality is very tenuous, in particular because the calculation of the VAT resource involves considerable use of statistical sources.

3.6. Moreover, the progressive capping of the VAT assessment base as a percentage of GNP with effect from 1988 has on the one hand helped to reduce the significance of the VAT resource in the financing of the budget and, on the other hand, it has accentuated the resource's macro-economic character via its link with the GNP.

3.7. Though the GNP resource is certainly not fiscal in nature, the situation is not very different for the VAT resource. This is so despite the fact that 'the system of VAT resources was designed to provide a source of Community financing that ensures a direct link between the European taxpayers and the Community budget' ⁽¹⁵⁾.

The contributory capacity of the Member States

3.8. The Decision on own resources states that the system of own resources must 'take into account the contributory capacity of the Member States', which is

⁽¹¹⁾ The Commission had proposed that 1 % of the base actually subject to VAT should be paid over to the Community. See COM (87) 101 final of 28 February 1987, p. 30.

⁽¹²⁾ These procedures were first laid down by Council Regulation (EEC, Euratom, ECSC) No 2892/77 of 19 December 1977 (OJ L 336, 27.12.1977, p. 8) and subsequent amendments and then confirmed by Council Regulation (EEC, Euratom) No 1553/89 of 29 May 1989 (OJ L 155, 7.6.1989, p. 9) and subsequent amendments. The first Regulation gave a free choice between the current method and a method, which was theoretically equivalent, based on the returns of taxpayers. Two Member States initially opted for the latter method but subsequently joined the other Member States, which were applying the revenue-based method.

⁽¹³⁾ On this point, see COM(87) 101 final of 28 February 1987, p. 5; COM(88) 99 final of 9 March 1988, pages 26-27 and COM(92) 81 final of 10 March 1992, p. 23.

⁽¹⁴⁾ COM(88) 99 final of 9 March 1988, p. 27.

⁽¹⁵⁾ COM(88) 99 final of 9 March 1988, p. 26.

⁽⁹⁾ Under Article 3 of Council Decision 94/728/EC Euratom of 31 October 1994 (OJ L 293, 12.2.1994, p. 9).

⁽¹⁰⁾ 'Outlook for the financing of the Community budget', green paper of 23 November 1978, EC Bulletin, supplement 8/78, paragraph 18.

indicated by the Gross National Product at market prices (GNP). The GNP, a derivative of the Gross Domestic Product at market prices (GDP), was chosen as an indicator of contributory capacity because it is supposed to measure the prosperity of a country and not, as is the case with GDP, its productive capacity.

3.9. However, under the Agreement on the European Economic Area⁽¹⁶⁾, these countries' contributions to Community projects are determined according to their GDP. The Commission also uses GDP to assess a Member State's 'ability to pay' in connection with the obligations provided for in Article 171 of the Treaty⁽¹⁷⁾. It must therefore be asked whether the notion of contributory capacity is being treated consistently, even though the contexts are different.

The system's corrective factors

The capping of the VAT assessment base

3.10. Whereas the call-up rate for the VAT resource had just been increased from 1 % to 1,4 % in 1985 to make up for the shortfall in resources, in 1988 it was decided to reduce the VAT resource's contribution to the budget and create a complementary resource based on the GNP. The intention was to take the contributory capacity of the Member States more accurately into account, and this was subsequently confirmed by the protocol on economic and social cohesion annexed to the Treaty on European Union and the current Decision on own resources.

3.11. The Commission had in fact pointed out⁽¹⁸⁾ that, by its very nature as a consumption tax, the VAT resource produced a regressive effect, whereby the least prosperous Member States (with their relatively high level of consumption and low savings rate) tended to contribute more than their share of the Community GNP would warrant. This meant that the VAT resource constituted a factor of imbalance in the Member States' financing of the budget, in particular from the point of view of 'equity'⁽¹⁹⁾.

3.12. The share of the VAT resource in financing the Community budget has gradually been reduced since

1988. As from 1999, the call-up rate for the VAT resource is to be limited to 1 % and the VAT base taken into consideration may not exceed 50 % of GNP⁽²⁰⁾.

3.13. In the Commission's opinion, the VAT resource does not represent the contributory capacity of the Member States and it even considers it to be inequitable — even after correction by capping. However, this resource has not been abolished and replaced by an increase in the GNP resource, although this would have been possible when the GNP resource was created in 1988.

3.14. Furthermore, even with the establishment of a capping ceiling at 50 % of GNP as from 1999, the bases of certain Member States will not be capped. Moreover, as the Court observed in its Opinion No 8/93, it is not necessarily the least prosperous Member States that benefit from this capping, even though the re-balancing of the resources was intended to benefit them.

3.15. The capping of the VAT resource introduced an element of distortion into the system. Some Member States (four in 1998) contribute to the budget purely in accordance with their contributory capacity (GNP), as a result of the capping of their VAT bases, while others contribute on the twofold basis of their contributory capacity and taxable consumption (VAT). However, as the Court has already noted⁽²¹⁾, the call-up rate for the VAT resource is based on the principle that it should apply in the same way to everybody. Moreover, a reduction in the share of the budget financed by the VAT resource could have been achieved without calling into question the generalised application of this principle, simply by reducing the call-up rate.

3.16. The VAT resource poses a problem of consistency. If it is to be considered a contribution by the Member States, it should logically have been abolished in 1988 and replaced by the GNP resource. If, on the other hand, it is meant to be a tax on the final consumption of European citizens, capping it in accordance with GNP may reasonably be questioned. Indeed, in the latter case, it should be considered a genuine own resource, and capping it would therefore not be justified because that would nullify its primary function.

⁽¹⁶⁾ Article 82 of the Treaty, signed in Oporto, on 2 May 1992.

⁽¹⁷⁾ Method of calculation of the penalty provided for in Article 171 of the EC Treaty (OJ C 63, 28.2.1997, p. 2).

⁽¹⁸⁾ COM(92) 81 final of 10 March 1992, pp. 4, 23 and 40.

⁽¹⁹⁾ Commission study on 'Budgetary contributions, expenditure of the European Union, budgetary balances and the relative prosperity of the Member States', 9 October 1997, pages 2-3.

⁽²⁰⁾ See Council Decision No 94/728/EC, Euratom of 31 October 1994 (OJ L 293, 12.11.1994, p. 9). These limits will remain applicable until the current decision on own resources is amended.

⁽²¹⁾ Annual Report of the Court of Auditors concerning the financial year 1991, paragraph 1.104 (OJ C 330, 15.12.1992).

Towards a twofold GNP

3.17. One might expect that macro-economic aggregates would always be used in their most complete form. Improvements in the calculation of GNP, both from the point of view of the field covered and from that of the concepts used⁽²²⁾, are to be introduced in 1999 via the new version of the European System of Integrated Economic Accounts (the 1995 ESA). However, in spite of the Commission's opposition, the legislation expressly prevent this new ESA from being used for the calculation of the GNP resource as long as the current Decision on own resources is in force⁽²³⁾. Consequently, the GNP taken into account in this context will still be based on the 1979 ESA (second edition). This decision also affects the determination of the VAT resource, inasmuch as the calculation of the weighted average rate, a key feature of the base (see paragraph 2.8), requires the breakdown of taxable transactions using national accounts. Here too the 1979 version of the ESA will continue to apply.

3.18. One may therefore wonder about the reasons for this exclusion, especially when, at the same time, discussions within the Council suggest that it is 'probable that the new system will bring about an increase in the Community's GNP and changes in the relationships between the GNPs of the Member States'⁽²⁴⁾. Amongst the nine Member States which supplied estimates during the preparatory work for the 1995 ESA, the difference compared with the present GNP (1979 ESA) was between - 9,7 % and + 5 %, depending on the country. According to the Commission, the new ESA was meant to make for the greater comparability required for the management of the economic and monetary union and the utilisation of aggregates from the national accounts for Community administrative calculations and, in particular, budgetary calculations⁽²⁵⁾.

3.19. When the GNP is being calculated according to the 1995 ESA, a particular problem is that of the subdivision of Financial Intermediation Services (FISIMs). The rules adopted by the Council stated that, for the purposes of the GNP resource, the utilisation of FISIMs would not be automatic but would be dealt with in a subsequent specific Council Decision to be adopted

unanimously⁽²⁶⁾. Nevertheless, in the Council's view⁽²⁷⁾, the subdivision of the FISIMs should bring about a major improvement in ESA methodology and a more accurate comparison of GDP levels⁽²⁸⁾ within the European Union.

3.20. This development is contrary to the objectives behind the GNP resource, namely the creation of a resource based on reliable and exhaustive data that are comparable from both the conceptual and practical points of view. It offends against the principle of the impartiality of Community statistics⁽²⁹⁾, which implies that they should be produced in an objective and independent way. The GNP resource is therefore in danger of becoming a purely financial contribution, ending up as a formula for budgetary cost-sharing among the Member States. If it is not based on the most refined calculation of the GNP (the 1995 version of the ESA), this GNP resource will introduce a bias in the measurement of the contributory capacity of the Member States. The Commission nevertheless intends⁽³⁰⁾ to accompany in future any proposal aimed at modifying the statistical definition of the GNP used for the calculation of own resources with an estimate in percentage terms of the difference between the GNP according to the 1995 ESA and the GNP according to the 1979 ESA taken into account for the own resources.

3.21. As a result, and in connection with the considerations under 3.9. above, the existence of two GNPs (relating to the 1979 and 1995 ESAs respectively) poses the problem of deciding which aggregate is to be used in other Community fields, such as, for example, decisions on which areas are to be eligible for structural measures.

3.22. Furthermore, calculating the GNP twice does not make for any qualitative improvements in the national accounts. On the contrary, it represents an inefficient use of available resources and is contrary to the general principles of Community statistics.

⁽²²⁾ For details of the amendments introduced by the 1995 ESA, see Commission Decision No 97/178/EC, Euratom of 10 February 1997 (OJ L 75, 15.3.1997, p. 44).

⁽²³⁾ The 1995 version of the ESA, introduced by Council Regulation (EC) No 2223/96 of 25 June 1996, Article 8 (OJ L 310, 30.11.1996, p. 1).

⁽²⁴⁾ Council Document No 7057/95 of 15 May 1995, p. 2.

⁽²⁵⁾ COM(93) 454 final of 22 October 1993, p. 41.

⁽²⁶⁾ Article 8 of Council Regulation (EC) No 448/98 of 16 February 1998 (OJ L 58, 27.2.1998).

⁽²⁷⁾ Third recital of Council Regulation (EC) No 448/98 of 16 February 1998.

⁽²⁸⁾ As stated under paragraph 3.8, the GNP is derived from the GDP.

⁽²⁹⁾ See Article 10 of Council Regulation (EC) No 322/97 of 17 February 1997 (OJ L 52, 22.2.1997, p. 1).

⁽³⁰⁾ Commission declaration in the minutes of the Council meeting on the occasion of the adoption of the regulation concerning the distribution of indirectly measured financial intermediation services in the context of the European system of national and regional accounts (SEC). Council document No 5450 of 21 January 1998.

Correcting budgetary imbalances

3.23. Whilst considering expenditure policy to be the main tool for the eventual solution of the problem of budgetary imbalances, the Fontainebleau European Council of 25 and 26 June 1984 nonetheless decided that any Member State that was bearing excessive budgetary costs in relation to its relative prosperity could benefit from a correction ⁽³¹⁾.

3.24. The correction of 'budgetary imbalances', as defined by the Fontainebleau European Council, consists of reducing the negative budget balance of the Member State in question by two thirds. For a given financial year, this balance is calculated by multiplying the difference between the Member State's percentage share of VAT-GNP contributions and its percentage share of 'allocated' expenditure by the total for 'allocated expenditure' ⁽³²⁾. This correction is financed by the other Member States.

No generalised application of the system

3.25. Even though the conclusions of the European Council of Fontainebleau state that any Member State with a budgetary imbalance in relation to its relative prosperity may apply for a correction, the current Decision on own resources only specifically grants it to one Member State.

3.26. There is therefore no generalised system enabling other Member States to benefit from such a correction, just as there is no monitoring procedure to examine that the said correction is still justified. A solution to this problem would be to amend the Decision on own resources. However, under Article 201 of the EC Treaty, any amendments to this Decision are subject to unanimous approval by the Member States and national ratification procedures.

⁽³¹⁾ According to the Commission, the aim of the notion of 'relative prosperity' is to determine the situation of the citizens of a country or a region in comparison with the average for the European Union. See the Commission study on 'Budgetary contributions, budgetary balances and the relative prosperity of the Member States', 9 October 1997, p. 9-10.

⁽³²⁾ The notion of 'allocated expenditure' is specified in the procedure for calculating the correction in favour of the United Kingdom (see, in particular, COM (85) 36 final of 21 February 1985, SEC 926 of 21 June 1988 and document No XIX/66/94). Essentially, it corresponds to all budgetary expenditure except that in favour of non-Member States and certain minor budget headings.

A possible extension to other countries

3.27. Without prejudice to any comments that could be made as regards the relative prosperity of the Member States, the criteria currently applied for revenue correction would enable six other Member States to qualify. This would have resulted, on the basis of the latest definitive figures available (for the financial year 1996), in an increase of between 2 900 Mio ECU (one Member State) and 12 400 Mio ECU (seven Member States) in the total amount spent on the correction (i. e. 22 % of the VAT and GNP resources for the financial year in question).

3.28. Moreover, given that the beneficiary States do not contribute towards financing it, this correction would actually largely be financed by Member States whose per capita GNP is lower than the Community average, which is the reason why these Member States are eligible for the Structural Funds in favour of the less prosperous countries.

An inadequate definition of the notion of a budgetary imbalance

3.29. As the Commission has rightly stated ⁽³³⁾, budgetary balances provide misleading interpretations or inaccurate assessments of the advantages to be gained from the European Union's expenditure policies. The fact is that budgetary flows shown in the accounts cannot be used to identify the multiplier effect of these Community policies. Because of the integration of the Member State economies within the single market, establishing a strict link between the destination of Community payments and the benefits accruing to the Member States is becoming increasingly open to question.

The possibility of using expenditure to restore the balance

3.30. The present method for calculating the correction of a budgetary imbalance neglects these considerations. The establishment of a ceiling for the rebate at two thirds of the negative balance, whatever its size, is arbitrary. Moreover, the objective of reducing a budgetary imbalance by calculations of this sort could have been achieved by the 'expenditure' side of the budget — for example by means of a flat-rate sum or by readjusting the balance among the measures financed by the Community, as the Fontainebleau European Council recommended.

3.31. The choices made by the budgetary authority when it adopts the budget have different direct or

⁽³³⁾ Commission study: 'Budgetary contributions, the expenditure of the Union, budget balances and the relative prosperity of the Member States', 9 October 1997, pp. 7-8.

indirect effects in the Member States according to the individual economic sectors concerned. In this connection, the Court carried out a simulation on the basis of the general principles and notions currently used for project assessment and cost-benefit analyses⁽³⁴⁾. The statistical data from the input-output tables and the trade flows between the Member States were used to identify the effects on the output of the economic sectors of the countries concerned⁽³⁵⁾. These data made it possible to quantify the links between the various productive sectors and, in particular, the relations between the productive structures of one country and those of others (Community or otherwise).

3.32. The aim of this exercise was to assess the economic output flows generated both within and among the Member States by a given hypothetical piece of expenditure in their favour in the sectors of agriculture (50 % of the hypothetical expenditure), infrastructure (40 % of the expenditure) and services (10 % of the expenditure). The result was that the additional output generated by expenditure granted to a given country was not limited to the country in question, but could extend to other countries (including non-Member States) as a result of imports/exports of goods and services. Effects could also be identified in economic sectors which were not direct beneficiaries of Community payments.

3.33. The multiplier effect in terms of output generated by the expenditure was, overall, about twice as high as the expenditure itself. However, probably because of differences in the productive structures of the various countries of the Union, this effect may vary considerably from one Member State to another. In relation to expenditure, the multiplier effect is between + 48 % and + 111 %. This does seem to confirm that, in this context, the sectors where the Community intervenes do indeed determine the benefits that a country obtains from its membership of the Union. It therefore follows that it is the effects of budgetary policy choices, rather than mere financial flows, that provide the most appropriate information as to any imbalances.

⁽³⁴⁾ See, for example: UNIDO — Guidelines for project evaluation — Vienna, 1972; W. Leontief — Input-Output economics — Oxford University Press, 1996, NY; H.B. Chenery — Interindustry economics — J. Willey & sons, 1959, NY; Chervel-Le Gall — Manuel d'évaluation économique des projets, la méthode des effets — Ministère de la Coopération, Paris, 1976; Costa — Interdipendenze industriali e programmazione regionale — Franco Angeli, Milano 1978.

⁽³⁵⁾ These data refer to 1991, the last year available.

The importance of statistics in the calculation of the VAT and GNP resources

3.34. Macro-economic data, deriving from national accounts statistics, on which the GNP resource is based, also play a major role in the determination of the VAT resource.

3.35. For the VAT resource, calculating the Weighted Average Rate (WAR) requires statistical data so that the weighting of the VAT rates applied to the various taxable transactions can be established. These data, which correspond to the net values of the transactions that have been carried out, are broken down by VAT rate on the basis of statistical data from the national accounts (ESA) or other sources. Nevertheless, compiling the necessary data requires practical efforts so as to reconcile the statistics on taxable transactions.

3.36. For harmonisation purposes, corrections or compensations need to be made when calculating the VAT assessment base. It is not always possible to determine these adjustments, which in 1995 represented percentages varying, according to the State, between 0,09 % and - 5,66 % of their base, on the basis of adequate tax data⁽³⁶⁾. Where these are lacking, national accounts data or suitable other sources are used.

3.37. By its very nature, the GNP is a statistical aggregate drawn up in the context of the national accounts to measure the result of the overall activity of an economy over a given period. It covers all the economic transactions of all the parties concerned, whether commercial or non commercial. It enables presentation from three viewpoints⁽³⁷⁾ — 'production', 'expenditure' and 'revenue' — thus allowing a detailed macro-economic analysis, in particular for purposes of temporal and geographical comparisons.

3.38. This aggregate is drawn up by the statistical services of the Member States in accordance with national systems, principles and methods. The creation of the European System of Integrated Economic Accounts (ESA) introduced a uniform framework of definitions for the Member States. Directive No 89/130/EEC, Euratom established procedures for harmonisation from the conceptual, technical and organisational points of view.

⁽³⁶⁾ See the Court's Statement of Assurance concerning the financial year 1995, Table 3.2 (OJ C 395, 31.12.1996, p. 37).

⁽³⁷⁾ For the details in the presentation of the GNP according to the three viewpoints and their respective components, see Directive 89/130/EEC, Euratom.

3.39. It is the Commission's responsibility to ensure the consistent and uniform application of the rules for national accounts, because high quality statistical data are needed not only for the GNP resource but also for the completion of the internal market and for the coordination of national economic policies and the formulation, application, monitoring and evaluation of the policies provided for in the Treaty.

The need for a measure of data quality

3.40. Statistical data are drawn up by the Member States, under their own statistical systems. This, practically inevitably, leads to a certain degree of heterogeneity. However, these statistics must be harmonised and their quality measured if they are to enjoy the degree of confidence and legitimacy that is required for them to be used.

3.41. There are two aspects to the notion of quality as applied to statistical data: the comparability of statistical data between Member States and the specific reliability of each national system. The comparability aspect regards the level of equivalence of the specific standards, methods and sources of each national system. The reliability of each system is defined as the precision with which statistical data are drawn up in accordance with the applicable standards ⁽³⁸⁾.

3.42. For the GNP, Directive No 89/130/EEC, Euratom details the various dimensions of the quality of the GNP and stresses the importance of increasing its comparability and reliability. In this context, the Court would remind the reader of its previous comments ⁽³⁹⁾ recommending that, alongside its efforts to ensure the harmonisation and improvement of statistical systems, the Commission should develop instruments for measuring the quality of the GNP. The aim of this would be to accompany the statistical data of a given Member State with an indication of their intrinsic reliability and their quality in relation to those of other Member States. The Commission has taken the initiative of launching two pilot studies to examine the feasibility of developing a measure of the reliability of the GNP.

⁽³⁸⁾ The notion of reliability is defined in this way in Council Regulation (EC) No 322/97 of 17 February 1997 concerning Community statistics (OJ L 52, 22.2.1997, p. 1): 'Reliability is the fact that Community statistics should reflect, as closely as possible, the reality that they are meant to represent' (Article 10).

⁽³⁹⁾ Annual Report of the Court of Auditors concerning the financial year 1995, paragraphs 1.104-1.128 (OJ C 340, 12.11.1996).

A complex and inefficient management system

3.43. Although it is a system of financial contributions by the Member States, the VAT and GNP resources system is not a simplified system. Paradoxically, it contains all the constituent components of a traditional budgetary system based on tax revenue. In this connection, there are a number of comments to be made on the procedures for the estimation and rectification of the assessment base.

Estimating the assessment bases

3.44. During the implementation of the budgetary procedure, the Commission establishes estimates of the VAT and GNP bases. Independently of exchange variations between national currencies and the ECU, differences, sometimes significant differences, have been noted compared with the actual bases. During the 1989-1995 period, for the VAT resource, the maximum divergences between estimated and actual bases were between - 5 % and + 9 % for the Member States as a whole. For the GNP resource, this same divergence was between - 6 % and + 3 %. As overall resources available for financial year n, as determined at the beginning of the year n-1 on the basis of an estimate of the Community's GNP, are not rectified during year n, the quality of the estimates is particularly important.

3.45. It is questionable whether the forecasting procedure, which involves administrative costs, should be preserved under the current system of financial contributions. Some thought could be given to replacing it with the use of definitive (even old) data, with results that would be at least as close to reality as those achieved via the estimates. The data used could then be based on mean values in order to avoid cyclical and short-term effects, and on a sufficient number of financial years. This principle had already been applied to the system of own resources until 1987, when not all the Member States had set up their VAT systems ⁽⁴⁰⁾.

Rectifications of the bases

3.46. The VAT and GNP assessment bases are rectified in two ways: on the one hand corrections are made on

⁽⁴⁰⁾ Under the Decision of 21 April 1970 and Article 13 of Council Regulation No 2891/77 of 19 December 1977, the financial contribution of any Member State not applying the VAT system was based on its GNP's share in the sum of the GNPs of the Member States, with reference to the first three years of a period of five years preceding the budget year in question.

the basis of the real assessment bases at the end of the year following the financial year in question (see paragraph 3.47). On the other hand, multiple corrections are carried out following audits by the Commission.

3.47. Where the Commission judges an aspect of the calculation of the base to be incorrect, it lodges a reservation, which enables, where necessary, the necessary adjustments to be made for the current financial year as well as for the previous accounting periods. In addition, Member States are also entitled to lodge reservations. At the end of the financial year 1997, there were 117 reservations for the VAT resource and 120 for the GNP resource, the majority of which concerned the exhaustiveness of the GNP.

3.48. These reservations usually stem from problems relating to the statistical data used for the calculation of the bases, or even from cases of infringement of the legislation, in particular in respect of the application of the Sixth Directive, on the Common VAT Regime ⁽⁴¹⁾.

3.49. The Court has already noted, on several occasions, ⁽⁴²⁾ that the resolution of outstanding cases is particularly laborious because it sometimes requires additional work. It takes several years, during which discussions are held with the Member States. This is shown by the fact that, although the Commission declared, in 1991, that it would lift the reservations two years after its checks, six years later it declared this commitment to have been unrealistic ⁽⁴³⁾.

3.50. In the notification of reservations for the VAT resource, no account is taken of the fact that, for certain Member States whose assessment base has been reduced by capping, reservations that might increase the base will for this reason have no effect. Except where work undertaken in this connection is likely to bring about improvements in other fields (statistics, tax legislation), the point of these procedures is not clear.

⁽⁴¹⁾ The Council's Sixth Directive No 77/388/EEC of 17 May 1977 (OJ L 145, 13.6.1977 and subsequent amendments).

⁽⁴²⁾ See: the Annual Report of the Court of Auditors concerning the financial year 1988, paragraphs 4.16-4.31 (OJ C 312, 12.12.1988); Annual Report of the Court of Auditors concerning the financial year 1989, paragraphs 1.74-1.80 (OJ C 313, 12.12.1990); Annual Report of the Court of Auditors concerning the financial year 1991, paragraphs 1.99-1.102 (OJ C 330, 15.12.1992); Annual Report of the Court of Auditors concerning the financial year 1995, paragraphs 1.69-1.71; Annual Report of the Court of Auditors concerning the financial year 1996, paragraphs 1.137-1.147 (OJ C 348, 18.11.1997).

⁽⁴³⁾ The Annual Report of the Court of Auditors concerning the financial year 1996, paragraph 1.139 and the Commission's reply thereto.

3.51. When an agreement is found as to the corrections that need to be made, this modifies the Member States' respective contributions to the Community budget for several financial years previously. In 1997, corrections were made as far back as the financial year 1982. These corrections are generally not subject to interest on arrears, which, however, should be charged given the delays that occur in the resolution of outstanding cases.

3.52. However, corrections of the assessment base in connection with budgetary imbalances are only taken into account up to the financial year $n+4$, that is to say when the correction is adopted definitively. Consequently, the latter cannot be affected by corrections beyond this time limit.

An imprecise legal framework

3.53. The legal framework governing the VAT and GNP resources is not precise. Some examples are given below.

Adaptation of the regulations on the VAT resource

3.54. Following the introduction of the transitional regime for VAT on intra-Community trade on 1 January 1993, the Commission considered it necessary to add provisions to Regulation No 1553/89 ⁽⁴⁴⁾ to adapt it to the changes in the VAT system. At the same time, the Commission also wished to act in response to certain comments by the Court and the European Parliament ⁽⁴⁵⁾. A technical annex was also planned so as to formalise in legal terms certain practices to be followed so that the VAT assessment base could be determined in a uniform manner.

3.55. According to the Commission, the provisions proposed for adoption by the Council would have involved modifications of the national bases and hence of the VAT resource itself ⁽⁴⁶⁾. It withdrew this draft Regulation in 1996 after it had found that the Council was not in a position to adopt it.

⁽⁴⁴⁾ Council Regulation No 1553/89 of 29 May 1989 (OJ L 155, 7.6.1989, p. 9).

⁽⁴⁵⁾ The Annual Report of the Court of Auditors concerning the financial year 1990, paragraph 2.32 (OJ C 324, 13.12.1991). Decision of the European Parliament of 18 November 1992 concerning the discharge for the financial year 1990, paragraph 19 (OJ L 19, 28.1.1993, p. 26).

⁽⁴⁶⁾ See COM(92) 580 final of 18 December 1992, p. 12.

Data to be used for the calculation of the Weighted Average Rate

3.56. Article 4 of Regulation No 1553/89 states that the national accounts to be used for the calculation of the Weighted Average Rate are those for the year $n-2$. However, exceptions are possible, whereas, as the Court pointed out in its Opinion No 6/93 ⁽⁴⁷⁾, the existence of a European System of Integrated Economic Accounts (ESA) presupposes the availability, in all the Member States, of national accounts based on the same reference years at the right time for the transmission of the VAT resource statement.

3.57. This same provision allows the use of data from outside the ESA on condition that they are from a 'suitable source'. Until this concept is defined inequalities in the determination of the Member States' bases will continue to be possible.

The entry of own resources in the accounts

3.58. The applicable provisions ⁽⁴⁸⁾ state that the own resources are to be paid into an account opened in the name of the Commission in each of the Member States. The Member States are required to send a statement to the Commission after each transaction, within seven working days. Practice concerning the transmission of these statements (once a day, or even after months have elapsed), as well as the indication of the payment date (value date and/or date of entry in accounts) varies considerably from one Member State to another. The result is that the Commission is not permanently informed, in a direct and independent manner, of the actual situation regarding its assets. This is contrary to the notion of an own resource and can cause cash management difficulties or even payment difficulties.

3.59. Budgetary imbalances are corrected by a detailed calculation procedure worked out by the Commission. First of all, the latter makes a calculation that takes into account the principles adopted before the 1988 Decision on own resources, when there was no GNP resource and the VAT resource was not capped. This calculation is then adjusted to take account of the current Decision on own resources. In practice, this means two calculations. As the Court observed in its Annual Report on the financial year 1991 ⁽⁴⁹⁾, it would be simpler and more transparent to use one calculation method only.

⁽⁴⁷⁾ OJ C 227, 23.8.1993, p. 2, paragraph 6.

⁽⁴⁸⁾ Council Regulation No 1552/89 of 29 May 1989, Articles 9 and 12 (OJ L 155, 7.6.1989, p. 1).

⁽⁴⁹⁾ The Annual Report of the Court of Auditors concerning the financial year 1991 (OJ C 330, 15.12.1992, paragraphs 109-110).

3.60. Separating the calculation of the VAT resource from that of financing the correction would make it possible to avoid subsequent complications. The amount of the correction and the financing of it result in a substitution effect between the VAT and GNP resources, which modifies the respective shares of the Member States and must be taken into account for both the estimated and definitive calculations.

4. THE VULNERABILITY OF THE VAT AND GNP RESOURCES

Effects of losses of tax revenue on the VAT and GNP resources

4.1. The Community's ability to meet its expenditure obligations does not depend on the degree of efficiency shown by the national authorities in collecting VAT and preventing fraud. Under the terms of the Decision on own resources, the GNP resource may in fact be used to compensate for a budgetary imbalance in the event that other resources are inadequate.

4.2. However, as the Commission has pointed out ⁽⁵⁰⁾, these differences in degree of efficiency are not without effects on the Community's finances. Tax evasion and underground economic activities may affect both VAT income and the calculation of the GNP unless suitable adjustments are made. Consequently, this could affect not only the financial breakdown among Member States, but also the maximum ceiling of budgetary resources which is established as a percentage of GNP.

4.3. The components of the VAT assessment base are also at the base of taxpayers' declarations for direct taxation and social security contribution purposes. The amounts at stake in these cases, moreover, are much higher than for VAT ⁽⁵¹⁾ alone, which may therefore constitute the main reason for the fraud. As a consequence, a simultaneous VAT fraud results from the need for the taxpayer's accounts to be consistent and the VAT fraud is therefore no more than a component of a more general loss of tax revenue.

The inherent risks of the VAT system

4.4. Under the VAT system, taxpayers in principle have an interest in insisting on invoices so as to be able to

⁽⁵⁰⁾ SEC (92) 280 final of 24 February 1992, p. 5 (a).

⁽⁵¹⁾ For example, in one Member State, it was calculated that VAT represented around a quarter of the amounts paid in taxes by taxpayers.

deduct the VAT. This is why the Commission has stated that VAT is an 'inherently self-policing' tax ⁽⁵²⁾.

4.5. In actual fact, a taxpayer who wants to reduce the tax base to be declared (which, as shown under 4.3 above, is linked to that used for other taxes and social charges) has various ways of 'justifying' the plausibility of his accounts in the event of an audit.

4.6. In particular, the mechanism of deducting the input tax may induce taxpayers to declare undue production costs, backed, for example, by presenting formally irreproachable documents which, however, do not correspond to any economic reality or to any actual transactions. This concerns, in particular, false invoices. Such undue costs are difficult to detect because of the need for detailed cross-checks between a number of taxpayers.

4.7. In view of the financial stakes involved, presumed conflicting interests between taxpayers are not enough to guarantee compliance with the tax legislation. Compliance is more the product of other factors (public spiritedness, efficient checks, clear simple legislation, tax levels) than the supposed self-regulating machinery of the VAT system.

Ways of assessing losses of VAT income

4.8. In the case of VAT, the national accounts enable an assessment of the size of potential losses of revenue by comparing the tax base as calculated from the national accounts with that declared to the tax authorities by registered taxpayers. Where this latter factor is not

available, it is possible to carry out an indirect assessment by calculating the tax base implicitly declared on the basis of revenue collected. This procedure involves calculating the divergence between VAT revenue collected and what may be called the 'theoretical VAT'.

4.9. Despite the different approaches adopted by the Member States, the 'only reliable rule in this case is perhaps that theoretical VAT is higher than actual VAT revenue. This is the only means of guaranteeing that the national accounts have at least included a certain number of transactions that have been hidden from the tax authorities' ⁽⁵³⁾.

4.10. Theoretical VAT may be defined as 'the VAT which would be produced if all units liable to pay the tax actually paid it in accordance with the relevant legislation' ⁽⁵⁴⁾.

4.11. The discrepancy between revenue actually collected and theoretical VAT does not, in itself, constitute the amount of tax revenue lost. In actual fact neither of the two factors being compared is completely homogeneous. In particular, the figure for revenue collected is affected by bankruptcies, cancelled or deferred debts, the non-correspondence between revenue paid in and the financial year concerned. These factors are not entirely taken into account by the national accounts upon which the calculation of theoretical VAT is based.

4.12. On the other hand, the theoretical VAT is directly affected by the exhaustiveness of the national accounts and by their capacity to reflect taxable transactions which do not figure for various reasons (failure to update statistical records, shortcomings in statistical surveys, the existence of unregistered workers, cases where turnover is understated or undeclared). Furthermore, the Commission noted in 1994 ⁽⁵⁵⁾ that 'economic activity carried out contrary to fiscal and social legislation is currently not taken into account in the Member States' estimates in a uniform manner'. It admits that the underground economy does raise a not inconsiderable problem concerning the fiscal systems at present in use ⁽⁵⁶⁾, and that problem seems to have increased in recent decades ⁽⁵⁷⁾.

⁽⁵²⁾ Of frauds where the aim is not to pay VAT on sales, the Commission has said 'in such cases, the normal VAT mechanism of staged payment limits the gains to the fraudulent trader to the amount of VAT due on his value added and, as he does not declare his supplies, he will not be able to reclaim the VAT on his purchases. Moreover, if his customers require invoices and subsequently use them as a basis for deduction, the control administration has the opportunity to become aware of his existence. In these respects, the VAT system can be said to be inherently self-policing.' See detailed technical description of the Commission programme, 'A common VAT system', Annex B, p.40.

⁽⁵³⁾ Doc. Eurostat/B1/CPNB/093, p. 7. See also Doc. XIX/114/81, para. 14, p. 8.

⁽⁵⁴⁾ Doc. Eurostat/B1/CPNB/093, p.2.

⁽⁵⁵⁾ Commission Decision 94/168/EC, Euratom of 22 February 1994, fourth recital, OJ L 77, 19.3.1994, p. 51.

⁽⁵⁶⁾ COM(97) 559 final of 13 November 1997, p. 18.

⁽⁵⁷⁾ See COM(98) 219 final of 7 April 1998, p. 5.

Assessment work by the Commission and the Member States

4.13. In connection with its responsibilities as regards the collection of the VAT resource, the Commission has carried out work in this field, starting in 1981. This work was gradually extended to include the effects of VAT fraud on the calculation of the GNP.

4.14. Several Member States used the calculation of theoretical VAT to assess fraud and carry out the necessary adjustments with regard to the calculation of the GNP. Estimating total fraud, in particular that for fraud 'without the complicity' of the purchaser⁽⁵⁸⁾, is part of the work of the GNP Committee⁽⁵⁹⁾.

4.15. The figures given by the Member States, in particular in connection with the work of the GNP Committee, differ considerably, depending on the methods used and the degree of exhaustiveness of the national accounts. Nevertheless, this confirms, at a factual level, that divergences between collected VAT and theoretical VAT can mainly be explained by fraud. Such divergences provide a minimal assessment of the phenomenon (see paragraph 4.12).

Assessment work by the Court

4.16. Basing itself on the methods used, in particular, by the Commission departments in 1989, the Court replicated this exercise for nine Member States for the period running from 1991 to 1993. The Court's calculation was based, in particular, on data taken from the national accounts drawn up by the Member States for the establishment of the VAT assessment base⁽⁶⁰⁾. It was forwarded to the Commission and the Member States concerned.

⁽⁵⁸⁾ According to the definition of the GNP committee, fraud 'without complicity' occurs when the buyer pays the seller the price of a transaction inclusive of VAT, but the seller does not subsequently declare the transaction and pay the relevant tax. In contrast, in fraud 'with complicity' the transaction takes place exclusive of VAT. These two types of fraud make up all VAT fraud.

⁽⁵⁹⁾ This Committee, consisting of representatives of the Member States, is responsible for assisting the Commission in the verification of the calculation of the GNP. It was set up under Council Directive 89/130/EC, Euratom of 13 February 1989 concerning the harmonisation of the establishment of the GNP at market prices (OJ L 49, 21.2.1989, p. 26).

⁽⁶⁰⁾ In particular, this concerns data regarding the establishment of the Weighted Average Rate.

4.17. For the period in question, this calculation shows that there was a considerable difference between VAT collected and theoretical VAT⁽⁶¹⁾. On a weighted basis, the overall difference was more than 1 % of the total GNP of the countries in question. It accounted for almost 21 % of the total of revenue collected by these Member States, or an annual average of approximately 70 000 Mio ECU, an amount which is almost equal to the present total for the Community budget.

4.18. As stated under 4.12 above, this difference must be considered minimal, since it reflects the greater or lesser exhaustiveness of the national accounts during the period in question. The Court notes that, in connection with the calculation of the GNP⁽⁶²⁾, Member States are required to check the exhaustiveness of their national accounts so as to give adequate attention to economic transactions relating to the underground economy. On the basis of this operation, which is to be completed by 1 October 1998⁽⁶³⁾, it should be possible to obtain a figure that is more representative of economic reality.

4.19. If the results of the Court's calculation are compared with those of a similar calculation made by the Commission in 1989 for the 1980-1984 period, it will be noted, for the countries covered by the two enquiries at the time, that the overall difference as a percentage of revenue collected had increased by more than 60 % in ten years. This is an indication that VAT fraud is on the increase.

Theoretical VAT and the exhaustiveness of the GNP

4.20. In order to provide the Member States with a uniform framework of reference for the treatment of theoretical VAT revenue in their national accounts, the Commission plans to ask the Member States to carry out the necessary work on the treatment of theoretical VAT revenue simultaneously with the conclusion of the exercise on the exhaustiveness of the GNP. Nevertheless, at a distance of a few months from the expected conclusion date, no decision has been taken. The draft decision calls for some comments.

⁽⁶¹⁾ The Court compared theoretical VAT with both the net revenue given in the statement of VAT resources and with 'VAT charged on products' (R 21 in the nomenclature of the European System of Integrated Economic Accounts). The difference observed remained substantially the same.

⁽⁶²⁾ Commission Decision 97/619/EC, Euratom of 3 September 1997 (OJ L 252, 16.9.1997, p. 33).

⁽⁶³⁾ The deadline is 10 October 1999 for Austria, Finland and Sweden.

4.21. A method is proposed, but the Member States are free to continue to apply others on condition that they achieve comparable results. It will therefore be up to the Commission to ensure the validity of the sources and methods used as well the comparability of the results obtained.

4.22. The need to ensure that the data are completely comparable also applies to those Member States which are able to show that an equivalent calculation is already implicitly included in their national accounts, which will entitle them to be exempted from the exercise required under the terms of Article 4 of the draft Decision. Furthermore, in this connection, it should be remembered that Commission Directive No 89/130/EEC, Euratom and Commission Decision No 94/168/EC, Euratom of 22 February 1994⁽⁶⁴⁾ already state that adjustments ensuring the exhaustiveness of the GNP should be backed by appropriate calculations. The Commission should already be in a position to check these calculations.

4.23. The draft Commission Decision requires the Member States to make a distinction between fraud 'without complicity' (of the purchaser) and fraud 'with complicity'⁽⁶⁵⁾. The latter is defined as being perpetrated by economically active units that are not listed in the statistical records and carry out transactions without collecting and paying over VAT.

4.24. However, in the real economic world, it does not seem to be possible to distinguish between types of fraud in such a clear-cut fashion. In particular, it is difficult to establish whether the price paid for a transaction corresponds to a market price with or without VAT. It is possible for the purchaser not to make a profit where the price paid to the seller is actually equivalent to the price inclusive of VAT. This depends, in particular, on the equilibrium price between supply and demand. Consequently, distinguishing between fraud 'without (purchaser) complicity' and fraud 'with complicity' raises difficulties which neither the Member States nor the Commission can evade.

4.25. According to this draft Decision, registered taxpayers would not be involved in fraud 'with complicity'. However, as discussions within the GNP Committee have shown, this is questionable. In actual fact, registered and unregistered taxpayers alike may, with the agreement of the purchaser, carry out sales exclusive of VAT even though they are intended for final consumption. They may also connive to increase their tax

deduction rights unduly by over-assessing their intermediate costs, where necessary via false invoices.

4.26. The question also arises as to how the national accounts can adequately take into account fraud perpetrated by registered taxpayers. However, the Commission Decision and the debates within the GNP Committee provide only partial answers.

5. CONCLUSIONS

A question that must be addressed

5.1. Although it has made it possible to continue financing the budget under acceptable conditions, the VAT and GNP resource system is characterized by problems of consistency and transparency, as well as operational shortcomings, which should be addressed as soon as possible. This discussion is all the more urgent from the viewpoint of the enlargement of the European Union.

5.2. The structure and operation of the current system, which is just as detailed as a traditional budgetary system based on tax revenue, therefore seem disproportionate in relation to the nature of the VAT and GNP resources. A system of financial contributions does not call for the innumerable complications of the current system.

5.3. The presence of a form of revenue correction constitutes another anomaly of the system. Its conceptual basis, consisting in identifying the benefit that a Member State gains from its membership of the Union by calculating the difference between the money it pays in and that which it receives, is questionable. As the Fontainebleau European Council suggested, any imbalances should be corrected via expenditure policy. In actual fact, the time when political budgetary choices are made, when the Council and the Parliament are involved in their roles as budgetary authorities, is the right moment to direct the effects of Community funding, including geographically.

5.4. Furthermore, tax evasion, which is growing in an alarming fashion, and which must be fought first and foremost by the Member States, directly affects the establishment of the VAT and GNP assessment bases and may also affect the calculation of the GNP and therefore also the GNP resource itself.

Ambiguities that must be cleared up

5.5. Situations like that of the VAT resource, which started out as a tax but, in reality, has taken on the nature of a financial contribution, should be avoided. A

⁽⁶⁴⁾ OJ L 77, 19.3.1994, p. 51.

⁽⁶⁵⁾ The definition is given in note No 58 above.

resource based on the taxable consumption of citizens only has a *raison d'être* if it is based directly on a tax base declared by the taxpayers. It should also take into account the various factors making for losses of tax resources and endow the Union with suitable corrective instruments.

5.6. With regard to the GNP, the fact of not linking the GNP resource to the most up-to-date form of the GNP (the 1995 version of the ESA), as recent developments show, would make it impossible for it to mirror the contributory capacity of the Member States. Furthermore, the need to guarantee equivalent sources, methods and calculation procedures in the Member States means that the GNP must be evaluated in the light of instruments for measuring the quality of the national accounts. Such instruments ought to ensure that the GNP enjoys the legitimacy that the various uses to which it is put within the European Union require.

A choice that must be made: a consistent and transparent system

5.7. The history of the financing of the European Communities is sufficiently long to provide specific examples and practical experience with regard to the system that needs to be developed for the future.

5.8. This debate must provide a clear definition of the nature of the resources that should be allocated to the Community budget. It is not up to the Court to point out the possible choices. The implications of these choices are not neutral, for either the Member States or the Commission. The Court feels, however, that the precepts behind any system of financing must be clearly stated and there must be consistency between the nature of the resources selected and the methods used for collecting and auditing them.

5.9. Any new system should be simple, practical, related to the Member States' ability to pay and transparent. It should also be in accordance with the nature of the resources chosen.

A stable system that can be audited

5.10. The system to be selected must be able to guarantee the funds needed for financing Community policies in the long term. In particular, repeated changes in the legal framework should be avoided. In the recent past, the framework of the Decision on own resources was changed three times in ten years.

5.11. Lastly, the system must offer guarantees and procedures to make it both reliable and auditable. What is at stake is the confidence in it of those who are called upon to finance it, and the possibility of accounting to the taxpayers for its functioning and its compliance with the objectives upon which it is based.

This report was adopted by the Court of Auditors in Luxembourg at the Court meeting of 13 and 14 May 1998.

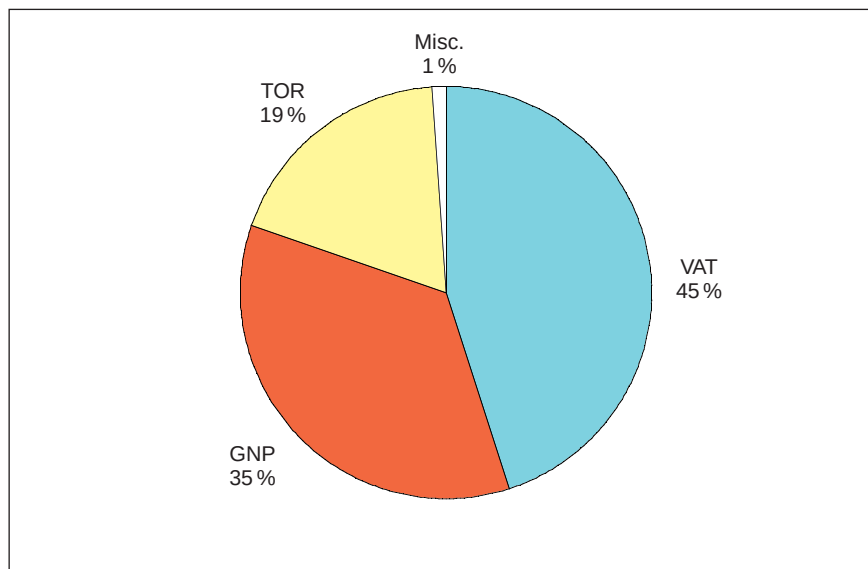
For the Court of Auditors

Bernhard FRIEDMANN

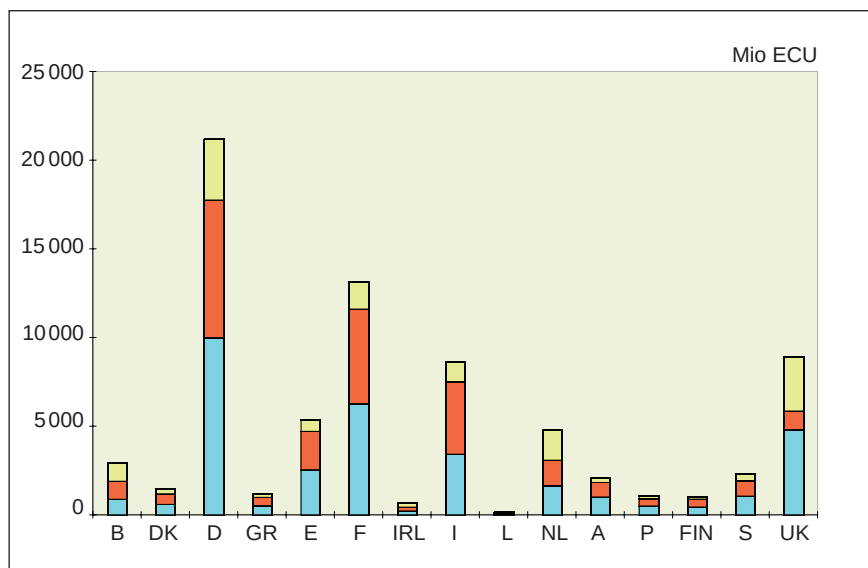
President

ANNEX I

The financing of the European Union in 1997

I. Total revenue by type ⁽¹⁾

Revenue	Mio ECU
VAT	34 230,12
GNP	26 890,6
TOR ⁽²⁾	14 172,27
Sub-total own resources	75 292,98
Misc.	870,64
TOTAL	76 163,62

II. Own resources by MS and by type ⁽¹⁾

MS	Mio ECU	%
B	2 971,41	3,95
DK	1 505,77	2,00
D	21 217,28	28,18
GR	1 178,4	1,57
E	5 367,62	7,13
F	13 185,88	17,51
IRL	686,96	0,91
I	8 667,11	11,51
L	170,69	0,23
NL	4 837,65	6,43
A	2 110,36	2,80
P	1 077,79	1,43
FIN	1 061,90	1,41
S	2 326,05	3,09
UK	8 928,11	11,86
TOTAL	75 292,98	100,00

⁽¹⁾ The amounts shown correspond to recoveries carried out during the financial year 1997.

Source: 1997 revenue and expenditure account, Volume I, part 1.

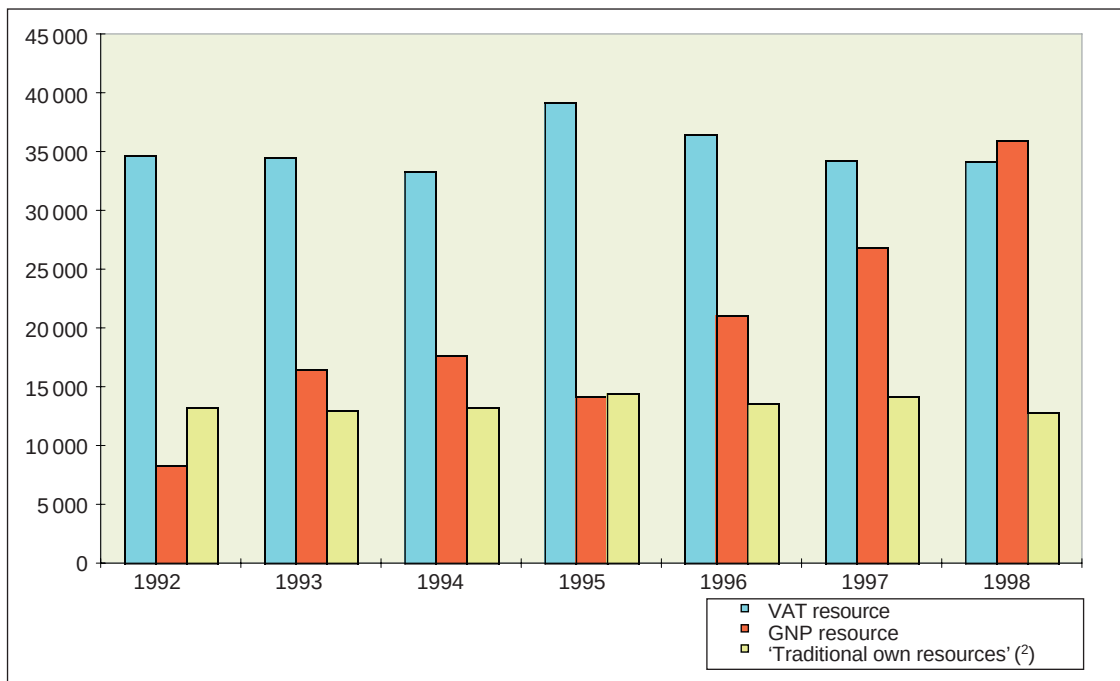
⁽²⁾ These are agricultural duties established by the institutions of the European Communities on trade with non-Member States in the context of the Common Agricultural Policy, plus levies and other entitlements provided for in connection with the common organisation of the markets in the sugar sector and duties under the common customs tariff and other entitlements established on trade with non-Member States (Article 2(1)(a) and (b) of Decision 94/728/EC, Euratom).

ANNEX II

The development of the VAT and GNP own resources (1992-1998)

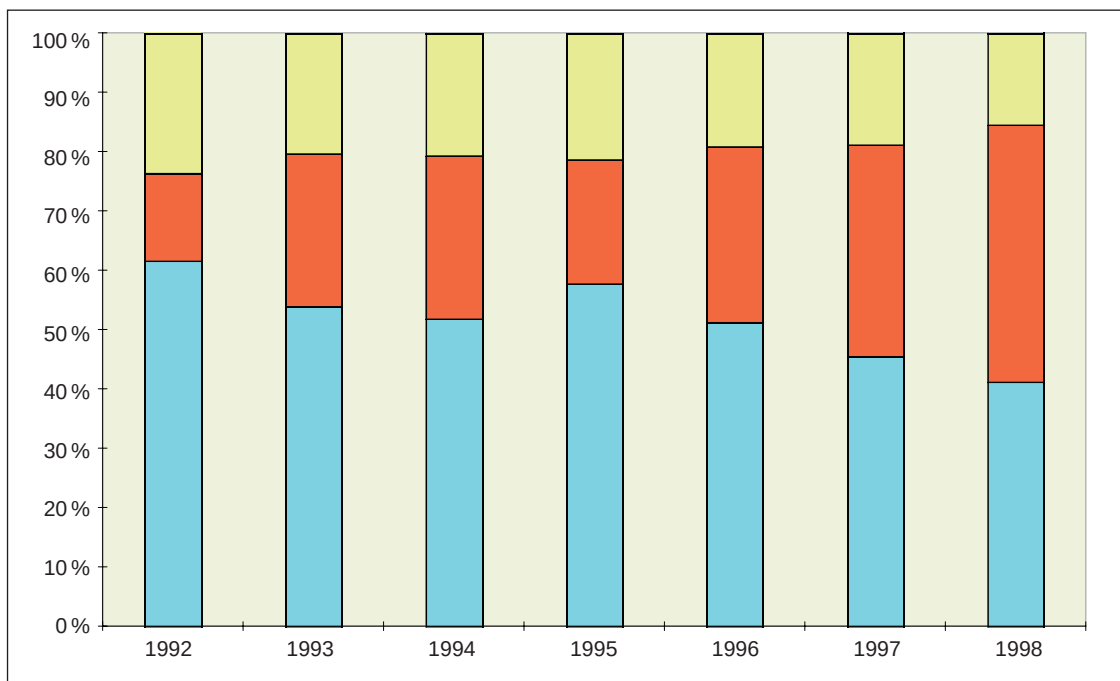
I. Development of amounts by type of resource ⁽¹⁾

(Mio ECU)



II. Development of respective shares

(in %)



⁽¹⁾ For the financial years 1992 to 1997, the amounts shown correspond to recoveries carried out during the respective years (source: revenue and expenditure accounts). For the financial year 1998, the amounts shown correspond to budgetary estimates from the 1998 general budget.

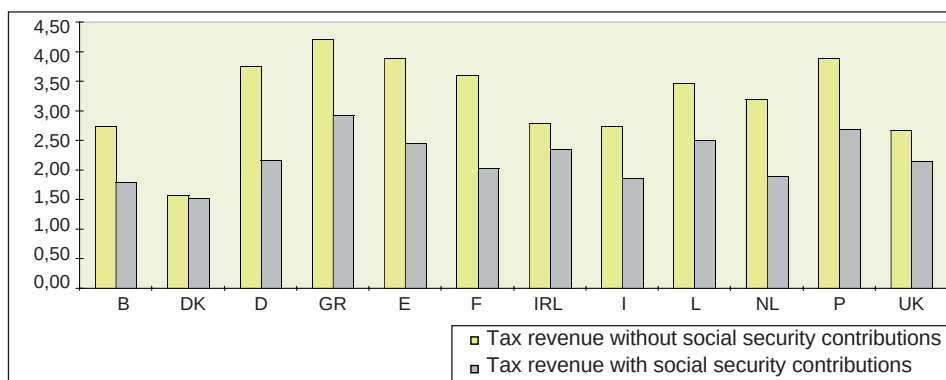
⁽²⁾ These are agricultural duties established by the institutions of the European Communities on trade with non-Member States in the context of the Common Agricultural Policy, plus levies and other entitlements provided for in connection with the common organisation of the markets in the sugar sector and duties under the common customs tariff and other entitlements established on trade with non-Member States (Article 2 (1) (a) and (b) of Decision 94/728/EC, Euratom).

ANNEX III

The VAT and GNP resources in relation to national tax revenue, population and GNP
(1992–1995)

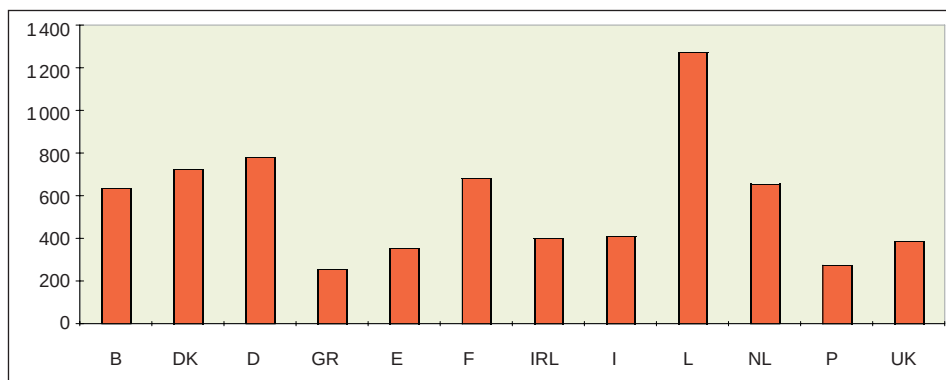
I. VAT/GNP resources / national tax revenue

in %



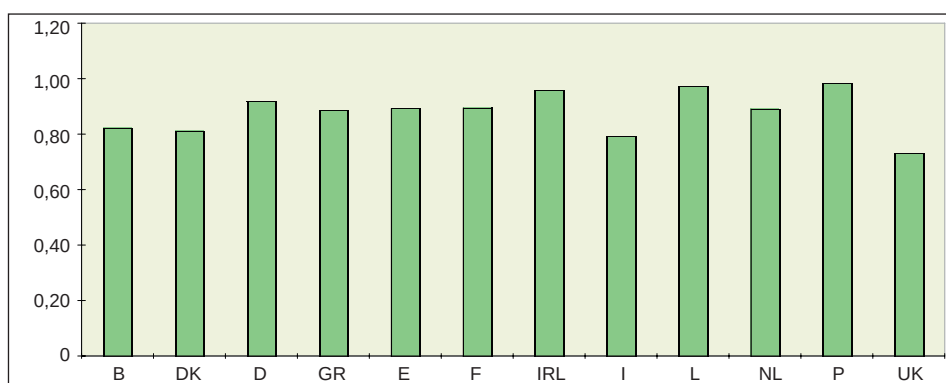
II. VAT/GNP resources / inhabitant

in ECU



III. VAT/GNP resources / GNP

in %



NB:

1. For the first table, the calculation for Greece was only made over three budgetary years (1992-1994) as against four for the other Member States (1992-1995); the 1995 data for tax revenue are not available.
2. The figures for national tax revenue are from Eurostat Newcronos database. These are indirect taxes (taxes related to output and imports — code 9980), direct taxes (on income and assets — code 9100, capital tax — code 9200), and social security contributions (code 9300).
3. The dates on the VAT-GNP resources come from the revenue and expenditure account drawn up by the Commission.
4. For the population, the figures used are those from the 'Basic statistics of the European Union', 33rd edition/1996, page 123.
5. The figures for GNP were taken from the 1996 GNP questionnaire, Eurostat/B1/CPNB/190/A/Rev.1 of 24 October 1996.
6. The exchange rates for the ECU are contained in Eurostat's publication 'National ESA accounts-aggregates', 1970-1995, page 101.

ANNEX IV

The main stages in the development of the system of own resources

- 1951: Article 49 of the ECSC Treaty provided that the High Authority (the Commission) was entitled to procure the funds necessary to carry out its task by setting levies on the production of coal and steel.
- 1957: Article 201 of the EEC Treaty envisaged replacing the financial contributions made by the Member States by own resources.
- 1970: Council Decision No 243/70 ECSC/EEC/Euratom of 21 April 1970 (OJ L 94, 28.4.1970) concerning the replacement of the Member States' financial contributions with the Communities' own resources. This decision stated that the Community budget, without prejudice to other income, was to be financed completely from own resources as from 1 January 1975.

This decision defined the own resources as follows:

- levies, premiums, additional or compensatory amounts, amounts or additional components and other duties established or to be established by the Community institutions on trade with non-member countries, within the framework of the common agricultural policy, as well as contributions and other entitlements provided for under the common organisation of the market in sugar;
 - duties under the Common Customs Tariff and other duties established or to be established by the Community institutions on trade with the non-member countries;
 - resources from Value-Added Tax obtained by the application of a rate which may not exceed 1% of the base, calculated in a uniform way for the Member States, in accordance with Community procedures.
- 1985: Council Decision No 85/257/EEC/Euratom of 7 March 1985 concerning the system of the European Communities' own resources (OJ L 128, 14.5.1985, p. 15). This Decision increased the call-up rate for the VAT resource from 1 % to 1,4 % and formalised the principle of the correction of budgetary imbalances.
- 1988: Council Decision No 88/376/EEC/Euratom of 24 June 1988 (OJ L 185, 15.7.1988, p. 24) concerning the system of the European Communities' own resources. This Decision introduced the notion of the capping of the VAT base in terms of a percentage (55 %) of GNP and created a new resource based on the GNP. This resource became a means of balancing the Community budget.
- 1994: Council Decision No 94/728/EEC/Euratom of 31 October 1994 (OJ L 293, 12.11.1994, p. 9) concerning the system of the European Communities' own resources. This Decision broadened the application of the capping of the VAT base in terms of a percentage of GNP (50 % in 1999) and reduced the call-up rate for this resource (1 % in 1999).
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THE COMMISSION'S REPLIES

A. GENERAL COMMENTS

The Commission agrees with the Court's emphasis on certain aspects of the present own resources system, in particular on the VAT resource and the mechanism to correct budgetary imbalances.

Concerning the former, the Commission sees the contradiction in the interpretation of VAT and the capping rules introduced in recent years. If the VAT contribution were to be considered as a tax on individuals, then the capping of the VAT base is not appropriate. However, capping of the VAT base would be logical if VAT contributions are seen as effectively national contributions. The Commission also sees the correction mechanism in favour of the United Kingdom as an anomaly.

The Commission takes note of the Court's views and comments on the operation of the own resources system. These views are important contributions to the emerging debate on the future character of the financing system and in the exploration of alternative possibilities. The Commission would also take the opportunity to stress that the present system has worked generally well. The system's weaknesses which have been singled out by the Court are largely the result of inevitable political compromises.

B. SPECIFIC COMMENTS

2. FINANCING THE COMMUNITY BUDGET

The VAT resource

In various paragraphs the Court expresses the concern that the VAT resource relies substantially on statistical methods with the result that it has little in common with fiscal reality. Although correct, this is a partial view that emphasises only one aspect of the process. One could clearly argue the opposite, that the VAT resource is based principally on fiscal data since they constitute the base on which statistical methods are applied in order to arrive at the harmonised base. Statistical data play a role, admittedly very important, in the calculation of the weighted average rate. In this case, however, what is important is the relationship between the categories that are submitted to different rates and not the absolute level of VAT receipts.

Determining and monitoring the VAT and GNP assessment bases

2.11. The data for the VAT and the GNP bases are used in the budget to determine provisionally the contributions of the Member States. The responsibility for establishing these data rests with the Commission. The Commission does so following an exchange of views with, and after soliciting the advice of, the Member States. The formal forum where these exchanges take place is the Advisory Committee on Own Resources (ACOR).

3. THE LIMITATIONS AND DISTORTIONS OF THE CURRENT SYSTEM

The contributory capacity of the Member States

3.9. The use of GNP (gross national product) and GDP (gross domestic product) in the different circumstances reflects primarily data availability rather than inconsistency. The use of

GDP in the case of the EEA was partly a reflection of the unavailability of GNP data for some small and very open economies such as Liechtenstein. Moreover, in order to be consistent with the Stability Pact, the use of GDP in Article 171 of the Treaty was preferred. Fundamentally, however, the use of GNP or GDP would play a lesser role in most cases except for Ireland and Luxembourg where net factor income from abroad is substantial.

The capping of the VAT assessment base

3.10.-3.16. The Commission shares the concerns of the Court in relation to the inconsistency implicit in the capping of the VAT base. Although the VAT resource is generally considered to perform poorly when judged by the criterion of equity in gross budget contributions, it has not, nevertheless, been considered appropriate to replace it but only to limit its undesirable aspects through capping and through a reduction in the VAT call-up rate.

Towards a twofold GNP

3.17.-3.22. The Court's commentary on the 'double GNP' is entirely to the point. The Commission regrets this situation and has expressed its dissatisfaction on several occasions. It is essential that the best available data are used in the determination of all EU activities and especially in the sensitive area of budget contributions.

The importance of statistics in the calculation of the VAT and GNP resources

3.36. As the figures quoted by the Court indicate, the adjustments made to eliminate the effect of differences in the VAT systems of the Member States are minor compared to the global base. Moreover, the Council has already adopted Commission proposals in this area, and the Commission will propose in the future measures which will contribute to reducing further the differences between the national VAT regimes.

The need for a measure of data quality

3.40.-3.42. The Commission considers that the examinations undertaken regularly by its services concerning the application of the rules governing national accounts estimates ensure a correct and satisfactory application of the GNP Directive. However, the Commission also recognises that research on the evaluation of the quality of macroeconomic aggregates is not entirely satisfactory, and partly in response to this it has launched a research project on an analysis and evaluation of the quality of national accounts aggregates. Two studies have been commissioned by Eurostat in this area, one conducted by the National Statistical Office of Italy (ISTAT) and one by the UK Office of National Statistics (ONS). The results of the former will be discussed by the GNP Committee in June 1998; the results of the latter will be available in 1999.

Estimating the assessment bases

3.44. The relatively large forecasting errors mentioned by the Court refer to a particularly unstable economic period covering the peak of the high growth cycle of the second half of the 1980s, the recession of 1993 and the recovery of 1995. The Commission believes that forecasts of budgetary variables constitute a better method of determining the provisional contributions of the Member States than relying simply on past averages and that the greater accuracy justifies

the extra efforts required. From 1998 the Commission has introduced in the first Supplementary and Amending Budget (SAB) for the year a review of forecasts involving the use of the most recent data; the new procedure will undoubtedly improve the accuracy of the forecasts of the provisional contributions.

Rectification of the bases

3.50. The Commission is examining the possibility of introducing an alternative system of controls that could minimise, or eliminate completely, unnecessary work. In this system, for example, there could be no 'reserves' if estimates for the VAT base relative to GNP are well above the capping threshold.

Adaptation of the regulations on the VAT resource

3.54.-3.55. The Commission had to withdraw this proposal as the Member States had expressed their opposition to these changes to Regulation No 1553/89. The changes were proposed in order to give legal form to the methods of calculation already applied in practice.

Data to be used for the calculation of the Weighted Average Rate

3.56. Article 4 of Regulation No 1553/89 allows data from years 'n-3', 'n-4' or 'n-5' to be used, by way of exception to the general rule, on condition that the national accounts for these years conform with the ESA. This exception is justified if there are particular problems or if data for year 'n-2' are not available when the statements of the VAT assessment bases must be sent to the Commission. This must be done before 31 July of the following year while the GNP data do not have to be communicated until October. Recently, one exception of this type was made for Germany because of statistical problems related to German reunification. The only exception being applied at present concerns Portugal. For the reasons which the Court gave in paragraph 3.50 (capping), this exception has no effect on the determination of the VAT resource that Portugal has to pay.

3.57. Since the ESA data are sometimes insufficient or not sufficiently detailed to allow certain components of the weighted average rate (WAR) to be correctly calculated, some other appropriate source must be used, such as sectoral or trade statistics. Such data vary according to the country and it is not possible to give a precise definition; clearly, if it is necessary to use these data, it will be possible to calculate the WAR correctly and therefore avoid differences in the fixing of the VAT assessment bases of the Member States.

The entry of own resources in the accounts

3.58. The Commission is aware of the existing differences in practices in this area and has already approached the Member States to request more uniform information in a standardised form.

4. THE VULNERABILITY OF THE VAT AND GNP RESOURCES

Effects of losses of tax income on the VAT and GNP own resources

4.2. The Commission agrees with the emphasis the Court is placing on the vulnerability of VAT to fraud and its implications for measuring the national, harmonised, VAT base. However,

it is important to stress that unrecorded economic activity has asymmetric implications for VAT receipts and for GNP statistics. In the case of VAT fraud, the under-recording results in a corresponding reduction in VAT receipts and, therefore, in the national VAT base and, *ceteris paribus*, the national contributions from this resource. On the other hand, national statistical services adjust the national accounts aggregates for the under-recording of economic activity and, to the extent that they are successful in doing so, GNP figures are not affected by the existence of an unofficial economy.

The inherent risks of the VAT system

4.4.-4.5. The Commission agrees that the possibility of fraud clearly exists in the case of VAT taxation, although compared with other taxes the system of VAT taxation has an important element of self-policing.

Ways of assessing losses of VAT income

4.12. Following the remarks of the Court in its annual report concerning the financial year 1995, the Commission has taken steps to monitor more closely the evolution in Member States' VAT revenue. The results of the bilateral discussions that subsequently took place with all the Member States were discussed at the meeting of Deputy Directors-General for Indirect Taxation on 24 March 1998. On this occasion, the Member States concurred with the operational procedure proposed by the Commission concerning the automatic transmission to the Commission of information about VAT receipts and about the reasons explaining their evolution.

Theoretical VAT and the exhaustiveness of the GNP

4.23.-4.26. The draft Commission Decision on the treatment of VAT fraud in national accounts demands that effectively the Member States make the distinction between complicity and non-complicity of the buyer. The Commission assumes that fraud with complicity concerns only those establishments which are not registered. This hypothesis would appear acceptable. It is possible that registered establishments in certain circumstances will engage in VAT fraud 'with complicity', in which case the evaluation of VAT fraud 'without complicity' in the sense of the draft Decision will diminish. VAT fraud 'with complicity' based on false receipts would produce the same effect. Consequently, the proposed method of calculation would correspond to a maximal estimation.

It is also essential to stress that the increase in theoretical VAT following the work on the underground economy will translate in general into an equivalent increase in fraud 'with complicity'. As a result, this type of calculations would have no effect on estimates of VAT fraud 'without complicity'.
