Finance, Accounting and Business Analysis
Volume 4 Issue 1, 2022
http://faba.bg

The Reform of the European Union System of Own Resources – Challenges and Prospects

Nelly Popova

University of National and World Economy, Sofia, Bulgaria

Info Articles

Keywords:
EU budget, own resources, reforms, economic integration

Abstract

The present article is devoted to the reform of the system of own resources undertaken in the context of adoption of the long-term EU budget for 2021-2027. Although the introduction of these reforms was a result of exceptional circumstances, the necessity to modernise the revenue side of the EU has been acknowledged for a long time. The changes in the system of own resources in 2021-2027 were driven mainly by the necessity to provide new sources of revenue to ensure the repayment of the debts incurred in relation to the post-pandemic recovery of the Member States. The second objective of the reforms was to diversify the revenue structure of the budget. The new instruments to finance the EU budget agreed by the Member States and the European Commission can be considered as "genuine" own resources since they are related to EU policy priorities. However, given the strong increase of EU expenditure after the pandemic and the imminent repayment of the common debt, the system of own resources faces important challenges.

*Address Correspondence:
E-mail: npopova@unwe.bg

INTRODUCTION

The EU budget has been the basis of the integration process. It has as a main purpose to fund EU policies and programmes and it is financed entirely with own resources. Over the past decades, however, the integration on the revenue side of the budget has considerably lacked behind with the last major reforms dating back to the end of the 1980s. Moreover, the predominant share of national contributions in the revenue structure has limited the capacity of the budget to adjust to changing context and to finance new EU priorities and policies. Although the necessity to reform the revenue side of the budget has been acknowledged for a long time, actions for reforms were taken only recently. The main driving forces have been the withdrawal of the United Kingdom from the EU and especially the severe economic crisis caused by the COVID-19 pandemic. The latter event influenced the outcome of the negotiations on the long-term budget of the EU for 2021-2027 in favour of more fiscal federalism, including the issuance of common debt to finance EU expenditure. The reforms in the system of own resources involved some changes in the already existing financing methods as well as the introduction of new types of own resources that are closely related to EU policies and priorities related to green transition and digitalisation.

Against this background, the present article is devoted to the reforms in the system of own resources agreed during the preparation of the EU long-term budget for 2021-2027. The purpose of the article is to analyse the main components of the reform package and to address some potential challenges and risks related to their implementation. Special attention is given to the proposed new types of own resources. The rest of the article is structured as follows: the second part outlines the main characteristics and developments of the revenue side of the EU budget since the beginning of the integration process; the third part analyses the main changes in the own resource system after 2021 and their prospects; and the fourth part concludes.

Main characteristics of the revenue side of the EU budget

The EU budget differs in many respects from national budgets and its fundamental principles are laid out in the Treaty on the functioning of the EU (TFEU). In particular, TFEU stipulates that the revenue and expenditure in the budget are to be in balance, which rules out the possibility to finance the budget with borrowing. The Treaty requires also that the Union provides itself with the means necessary to attain its objectives and carry through its policies and that the budget is financed wholly from own resources (Official Journal of the European Union 2012). The aim of these principles is to ensure fiscal discipline at an EU level. Additionally, the basic rules for the own resources system are laid down periodically in a Council decision adopted unanimously by the EU Council (European Commission 2022a).

As can be seen in Figure 1, the revenue structure of the EU budget has undergone significant changes since the beginning of the integration process. At the onset of the European Communities, their expenditures were covered entirely with financial contributions by the six founding Member States. The development of the first common policies led to diversification of the financing methods. The adoption in 1970 of the Decision on the replacement of financial contributions from the Member States by the European Communities' own resources was of key importance as the European Community was to be gradually given financial autonomy through the provision of own resources (European Communities 2000, 25).

Throughout the 1970s, the main own resources were the agricultural levies (including on the imports of agricultural goods from third countries) and the customs duties, which together raised almost 56% of total revenue. The remaining part of the revenue was covered by financial contributions from the Member States (under the heading Miscellaneous). In the following decades, however, receipts from customs tariffs and agricultural levies declined sharply, due to trade liberalisation on a global scale. Therefore, new financing sources were necessary to cover the increasing expenditure. Revenues from customs tariffs are referred to as Traditional Own Resources.[1] They are considered to be genuine own resources for the EU budget as they are derived from the common policies and they accrue directly to the EU budget (European Commission, 2017, p. 8). The area of customs duties falls under the exclusive competence of the Union. Member States retain, as collection costs, a certain part of the established amounts of Traditional Own resources. In the past, this share was 10%, but in 2001 it was increased to 25% and in 2014 it was set at 20% (European Commission 2014, 191).

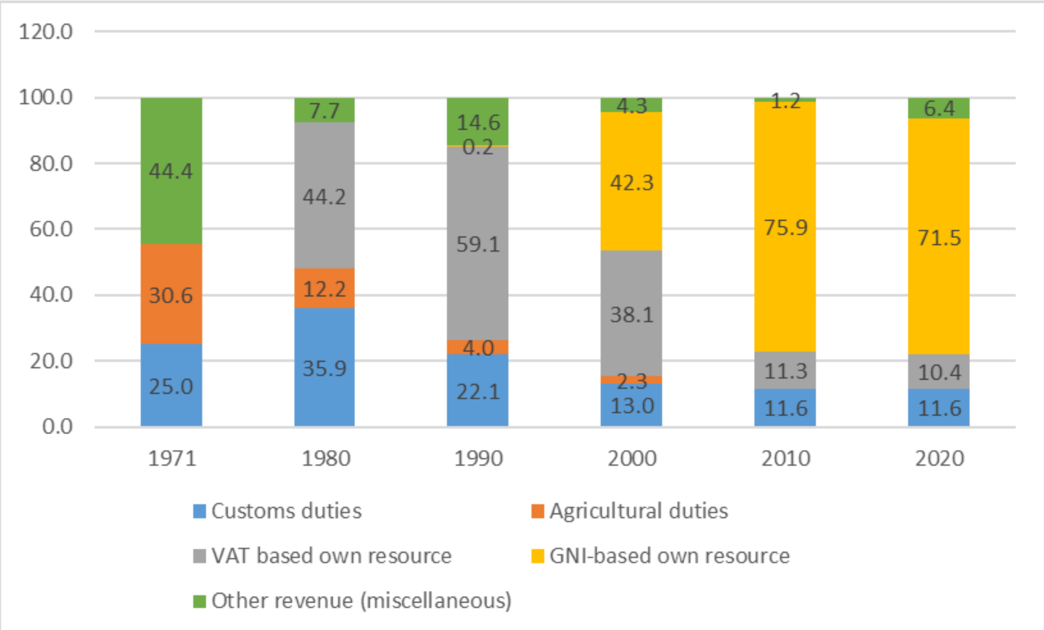
At the end of the 1970's, a new budget-balancing own resource was introduced on the basis of VAT revenue. It was calculated by applying a uniform rate (initially 1% and subsequently increased to 1.4%) to the VAT base of each Member State, also determined in a uniform method (European

[1] Subsequently, agricultural levies were incorporated into customs duties.

Communities 2000, 16). Between 1980 and 1990s the VAT-based own resource was the most important financing method as its share in total budget revenue reached almost 60%. The significant decline in the revenue from VAT-based contributions observed after 1990 is a result of several reductions of the call rate used to calculate the Member States' contributions (European Parliament 2019). Furthermore, the system for determining the VAT-based own resource has been criticised repeatedly by the Court of Auditors, the European Parliament and Member States as overly complex. The European Council of July 2020 has therefore concluded that it is appropriate to simplify the calculation of that own resource (Official Journal of the European Union 2020).

The system of own resources underwent its most important reform in 1988 after the establishment of the Single market and the territorial expansion of the European Community. To avoid yearly difficult discussions maximum ceilings by categories of expenditure are determined for a longer period, usually seven years, in Multiannual Financial Frameworks (Bisciari et al. 2021, 30). The reform introduced for the first time a ceiling of own resources (as well as expenditure) so as to contain the larger budget. Initially, the ceiling of the own resources was set at 1.3% of GNP; then, in early 1990s it was raised to 1.335% of GNP to support higher expenditure on the internal market and preparation for the euro. The own resources ceiling is normally much higher than the annual expenditure ceilings, thus allowing the EU to meet its payment commitments, even in the event of an unexpected economic downturn. In addition, there is a certain amount of scope to mobilise additional expenditure over and above the annual expenditure ceilings in the face of unforeseen circumstances, without impinging on the own resources ceiling (Deutsche Bundesbank 2020).

The 1988 reform involved also the introduction of a new own resource which was derived directly from the gross national product (GNP) of the Member States. At the end of 2000s the basis for calculating the Member States' contributions as well as Own resources ceiling was changed from Gross national product to Gross national income. The GNI-based contributions (also known as national contributions) were established as a residual element of the system of own resources to ensure that all agreed expenditures in the annual budgets are sufficiently covered and to guarantee that the EU budget is always balanced at the stage if its adoption (European Commission 2022b). Nevertheless, they gradually became the most important financing method of the EU budget. In 2010, national contributions reached almost 76% of total EU revenue and, although afterwards their share has decreased, as of 2020 they accounted for around 72% of total receipts. When combined with VAT-based contributions, the share of national contributions in the EU budget exceeds 80%.



Source: Own calculations based on European Commission data

Figure 1. Revenue structure of the EU budget

The original aim of the GNI-based contributions was to guarantee that the EU budget would be in balance. Another advantage of this financing method is that gross national income is an objective welfare indicator and thus it reflects the Member States' ability to pay. Moreover, as the contributions are fixed as percentage of GNI, their amount automatically adjusts in accordance with the business cycle stage.

Finally, GNI-based contributions ensure stability and regularity of budget revenue.

On the other hand, the GNI-based contributions are not a "genuine" Own resource for the EU budget, as they constitute a part of Member States' public revenue. As a result of their introduction, Member States increasingly measured the benefits from their EU membership by simply comparing the contributions to the EU to the direct cash receipts coming from EU programmes, ignoring the substantive benefits of joint action (European Commission 2017, 5). Furthermore, the reliance on this source limited the Union's possibilities to provide public goods with European dimension. Finally, several Member States from Northern Europe became net donors in the EU budget because their annual contributions exceeded the amount of the funds received under the Common agricultural policy. The claims for "fair return" led to the introduction of a financial rebate of 66% of United Kingdom's net contribution to the budget, which had to be financed by other Member States' contributions (European Parliament, 2019, p. 15). Subsequently, five other Member States from Northern Europe were also entitled to financial corrections of their contributions. The aim of these rebates has been to limit the financial burden on individual Member States which receive relatively low returns from the EU budget. However, all other things being equal, rebates for individual Member States increase the general GNI-based own resource, which all countries contribute on a pro rata basis (Deutsche Bundesbank 2020). Moreover, the complex system of corrections reduces the transparency of EU budget financing and creates recurrent tensions among the Member States.

After the introduction of the GNI-based own resource, progress to reform the revenue side of the budget was quite limited (European Commission 2021a, p. 5). There were changes only with respect to the ceiling of the Own resources, which was gradually reduced to 1.31% in 2007 of gross national income (GNI) and then to 1.29% of GNI in 2014 (cite). According to Buti and Nava (2003) the lack of any significant reforms can be attributed to the "budgetary peace" achieved in late 1980s between the institutions involved in the EU budget procedure, the Commission, the Council and the European Parliament achieved. The improved stability of the budget procedure reduced the flexibility of the budget and increased the complexity of its governing rules (Buti and Nava 2003 18). Another reason for the impasse is rooted in the limited competences of the EU in tax affairs. As Begg (2016) pointed out, the fact that the European Parliament has only a consultative role in the procedure for adoption of Own resources Decisions is in contrast to its co-decision role in expenditure and means that revenue raising in the EU is essentially an inter-governmental deal. At the same time, the difficulties for the Member States to agree on new financing methods are well-known. Most of them oppose to the introduction of "EU taxes" due to fears of loss of tax sovereignty.

In successive rounds of MFF negotiations, attempts have been made by the European Commission, usually with support from the European Parliament, to assign particular taxes to the EU. However, despite extensive efforts to identify and justify suitable new Own resources, the Member States have consistently rejected these initiatives on the grounds that tax setting is a power reserved to them. In practice, the EU has only pretty limited powers in relation to harmonisation of Value added tax designed to prevent distortion of competition, but has little influence other indirect taxes and none on direct taxes (Begg 2016, 5).

In recent years, the European Commission has emphasised the necessity to modernise and difersify the revenue side of the EU budget in order to strengthen its alignment with EU policies and priorities. Other important arguments in favour of reforms have been to design new Own resources that bring also additional benefits alongside new income streams, to bring more proportionality, fairness and stabilising impact to the EU budget, and reducing the weight of the GNI-based own resource in the EU budget.

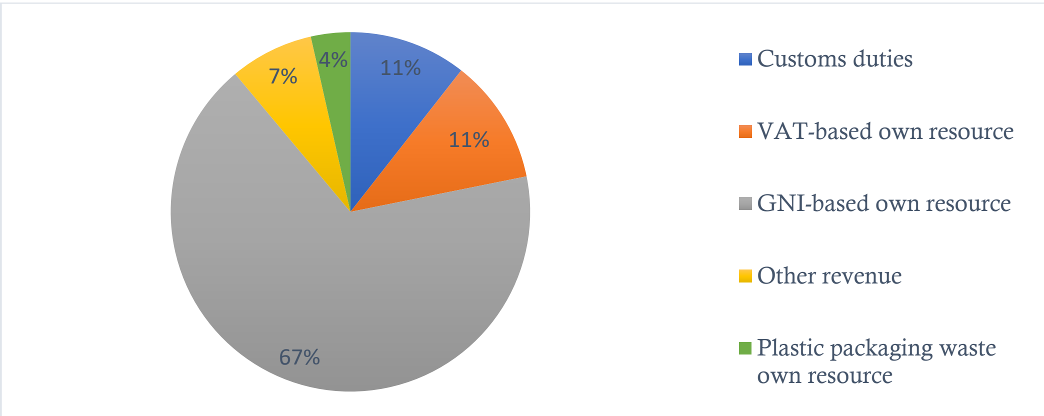
The proposals to introduce new sources of revenue in the 2014-2020 MFF did not receive the necessary unanimous support (European Commission, 2021, p. 5). During the preparation of the Multiannual Financial Framework (MFF) for 2021-2027, the Commission proposed a number of reforms to the System of Own resources. Among these was an elimination of all corrections on the revenue side of the budget as well simplification of the VAT-based Own resource. The reform package suggested also the introduction of three new Own resources, namely revenue from the emissions trading system, the Common Consolidated Corporate Tax Base and national contributions based on the amount of non-recycled plastic packaging waste. According to the Commission's calculations these new financing methods could amount to about 12% of total EU budget revenue which would allow reductions of the national contributions (European Commission, 2018, p. 27).

Reforms of the own resource System in 2021-2027 and prospects for the future

The negotiations on the EU long-term budget for 2021-2027 coincided with United Kingdom's withdrawal from the EU and the COVID-19 pandemic and were strongly influenced by them. Both events gave an incentive for significant reforms on the revenue side of the budget. The most important change, in response to the economic crisis triggered by the pandemic, was the start of borrowing by the European Commission on the financial markets to finance the expenditure under the recovery programme Next Generation EU (NGEU). Although NGEU is not a formal part of the Multiannual financial framework, it will have important implications on EU public finances in the future, because the loans will have to be repaid. To ensure that the EC will be able to cover all liabilities resulting from the NGEU, as a guarantee, the ceiling for payments has been raised to 2% of GNI. The need to resort to this additional allocation is temporary since the relevant financial obligations and contingent liabilities will decline over time as the borrowed funds are repaid and the loans mature. The increase should expire when all borrowed funds have been repaid, i.e. by 31 December 2058 at the latest (Bisciari et al. 2021 39).

The capacity of the EU to repay the debt incurred under NGEU will require either the introduction of new own resources or an increase in GNI-based contributions. Therefore, the Member States committed to reform the System of own resources (European Commission 2021a, 14). In order to better align the Union's financing instruments with its policy priorities, to better reflect the role of the Union budget in the functioning of the single market, to better support the objectives of Union policies and to reduce Member States' contributions based on gross national income (GNI), the European Council of July 2020 concluded that over the coming years the Union would work towards reforming the system of own resources and introduce new own resources (Official Journal of the European Union 2020).

The reforms on the revenue side of the budget were specified in the Decision on the system of own resources adopted from December 2020.[2] Among the most important changes was the introduction of a new type of own resource to finance the EU budget from the beginning of 2021, namely the national contributions based on the quantity of non-recycled plastic waste. Member states pay a levy of EUR 0.8 per kilogram of non-recycled plastic packaging waste, but a correction mechanism ensures that poorer Member States do not pay disproportionately high levies. Its objective is to create incentives for member states to reduce waste and increase recycling (Körner 2020). The adoption of the new own resource was symbolic as it broke a stalemate of more than 30 years (Reininger 2021). In terms of fiscal revenue, however, it is expected to have modest effects since the projected receipts amount to only EUR 5.9 billion or around 3.5% of total revenue in 2022 budget (European Commission 2021c).



Source: Own calculations based on European Commission data
Figure 2: Revenue structure of the EU budget in 2022

The reform of the own resources system included also a number of changes in the existing own resources, but most of them were not as ambitious as initially planned. Most importantly, the GNI-based contributions will not be subject to any significant changes in 2021-2027. The budget discounts for five Member States[3] will be kept despite the end of the United Kingdom rebate. While there was a general agreement to transform all existing corrections into lump sum discounts to some Member States' GNI-based contributions, the Member States could not reach a consensus on their reduction over time (European Commission, 2021a, p. 14). With regard to the VAT-based own resource, the uniform call rate will be kept at 0.3% in 2021-2027. However, the reform involved a simplification of the definition of the tax base used for the calculation of the VAT-based national contributions. Additionally, the reduced call rates applied previously for three Member States were abolished (Körner 2020). On the other hand, the

[2] Council Decision (EU, EURATOM) 2020/2053 of 14 December 2020 on the system of own resources of the European Union and repealing Decision 2014/335/EU, Euratom
[3] Austria, Denmark, Germany, the Netherlands and Sweden

amount of the contributions was capped at 50% of GNI, contrary to the Commission's proposal (Reininger 2021, 34) and implies less revenue from this resource in the EU budget. The most important change in the Traditional Own Resources was an increase of the retention rate of customs duties revenue for the Member States with 5 percentage points to 25%. The increase was in contradiction with the initial proposal, which envisaged the retention rate to be set at 10%, ant it will further reduce the share of customs duties in the EU budget after 2021.

In compliance with the Decision on the system of own resources, at the end of 2021 the European Commission put forward a proposal with three new sources of revenue to the EU budget, namely:

- an own resource based on the EU Emissions trading system (EU ETS);
- an own resource based on the Carbon Border Adjustment Mechanism (CBAM); and
- an own resource based on the taxation of the residual profits of multinational enterprises (European Commission 2021b).

Their introduction aims to bring in line the financing of the EU budget with the Union's long-term priorities, but also to help repaying the debt under NGEU. In particular, the establishment of the own resources based on EU ETS and CBAM is directly linked to the goals set in the European Green Deal to reduce net greenhouse emissions by at least 55% by 2030 and become climate neutral by 2050 (European Commission 2021c). On its part, the own resource based on the taxation of the profits of multinational enterprises reflects the efforts to adapt company taxation to digitalisation and reduce the possibilities for tax avoidance. The entry into force of the three new resources is scheduled at the beginning of 2023. Additionally, the European Commission will propose further own resources by June 2024, including a Financial Transaction Tax, a financial contribution linked to the corporate sector or a new consolidated corporate income tax base.

Table 1: New Own resources to finance the EU budget

Type of Own resource	Description	Projected revenue per year
Own resource based on the emissions trading system	Application of a uniform rate of 25% to the revenues generated from the auctioning of allowances by the Member States under the Emissions trading system	EUR 12 billion on average in 2026-2030
Own resource based on the Carbon Border Adjustment Mechanism	Application of a uniform call rate equal to 75% of the revenues from the sale of certificates of the carbon border adjustment mechanism	EUR 1 billion on average in 2026-2030
Own resource based on the reallocated profits of very large multinational enterprises	Application of a uniform call rate of 15% to the share of residual profit of multinational enterprises reallocated to Member States	Between EUR 2.5 and EUR 4 billion

Source: European Commission 2021d, 2021b

At this stage, the exact amount of the revenue from these new financial instruments in the EU budget cannot be determined with precision, but according to the European Commission's preliminary assessments, as presented in Table 1, the receipts would be relatively low. It should be noted also that the receipts from EU ETS and CBAM will completely deplete until 2050 if the targets of the Green Deal are met by the deadline. On the other hand, the repayment of the debt incurred under NGEU is scheduled until 2058. Therefore, new financing methods would be required in the future to cover the expenditure of the Union.

The practical application of these new financing methods is surrounded with uncertainties because of the technical complexities involved and mainly because they affect third countries. In case that these own resources are not introduced in the following years, or if the revenue that they raise is insufficient, the repayment of the loans under NGEU would require increases in Member States' GNI-based contributions.

The own resource based on EU's Emissions trading system (EU ETS) is the only new financing method that can be introduced relatively fast as this system already exists and it involves only the Member States. EU ETS sets an absolute cap on the greenhouse gas emissions from the activities under its scope and allows tradability of allowance. Currently, the revenues from emission trading accrue to national budgets, but part of them will be redirected to the EU budget after the entry into force of the new financing method. Fuest and Pisani-Ferry (2020) argue that the revenues generated under EU ETS are the best possible option for a new own resource and recommend that the entire amount of revenues accrue to the EU budget, rather than to the Member States where the emissions occur, to better reflect the negative externalities from pollution. These authors assess that under a realistic decarbonisation scenario, revenues from the emission trading system over the 2020-2050 would be sufficient to repay the NGEU debt. However, according to the Own resources Decision, only 25% of Member States' revenues from the auctioning of allowances will be directed to the EU budget with the remaining part left to national budgets.

To avoid an excessively regressive impact on contributions from the emissions trading, a maximum contribution will be established for eligible Member States (European Commission 2021b).

The own resource based on the Carbon Border Adjustment Mechanism (CBAM) will consist in the application of a uniform call rate of 75% of the revenues from the sale of certificates to companies from third countries for the imports of carbon-intensive products. Its main objective is to avoid the so-called carbon leakage by charging additional prices on the imports of carbon-intensive products from third countries. CBAM is designed to function in parallel to the EU's Emissions Trading System (EU ETS) to complement its functioning on imported goods and the ultimate goal is to replace the existing EU mechanisms, in particular the free allocation of EU ETS allowances (Council of the European Union 2022a). Unlike EU ETS, the border adjustment mechanism will not establish quantitative limits to import, so as to ensure that trade flows are not restricted. Another difference between the two regimes is that the EU ETS applies to installations in the Union, while the CBAM should be applied to certain goods imported into the customs territory of the EU (Council of the European Union 2022 8). Thus, the CBA is comparable to custom duties (Körner 2020). The mechanism is expected to start raising revenue only after 2026, due to a necessary transition and information gathering period. Furthermore, the war in Ukraine could impact the stability of the mechanism as an own resource for the EU budget (Bray 2022). In an empirical study Bellora and Fontagne (2022) concluded that CBAM would be more efficient than free allowances in reducing carbon leakages. These authors argued also that there is a tension between two polar approaches in designing the European CBAM: on the one hand, a more conservative approach that minimises the risk of retaliation by trading partners but has a smaller environmental impact; on the other hand, a more complex design that reduces the leakages to a much greater extent, that limits the cost for EU exporters of ETS products, but discriminates more between trading partners.

The third new own resource proposed by the European Commission involves the application of a uniform call rate of 15% to the share of residual profit of the largest multinational enterprises reallocated to the Member States (European Commission 2021b). The introduction of this instrument is related to EU's objective to modernise the rules for taxation of the profits generated by the largest multinational companies operating in the digital economy. Over the past years, there have been several proposals for reforms in the field of company taxation on an EU level, but none of them has obtained the necessary unanimous consent of the Member States. The introduction of this own resource, however, depends on the implementation on a global scale of a minimum tax rate of 15% on the profits of multinational enterprises. Over 130 countries worldwide have reached a principal agreement on the implementation of such a tax from the beginning of 2023 within the Base Erosion and Profit Shifting (BEPS) Project of OECD/G20 (OECD 2022), but the formal adoption of a Multilateral Convention is still pending.

Overall, the changes in the own resource system have been much more limited in comparison to the significant increase in expenditure after 2021. The uneven development of the revenue and expenditure sides of the EU budget gives rise to risks to fiscal sustainability.

CONCLUSION

Despite the deepening integration in the European Union, the revenue side of the Union budget has evolved in the opposite direction with the share of the "genuine" own resources, such as customs duties, decreasing at the expense of national contributions. The lack of significant progress towards the development of new financing methods can be attributed to the rigid procedures related to the adoption of the long-term EU budget as well as to the reluctance of the Member States to renounce sovereignty in taxation.

The reforms in the system of own resources introduced with MFF 2021-2027 constitute an important advance given the lack of any major reforms in the past decades. Moreover, they diversify the revenue structure of the EU budget and increase the share of "genuine" own resources that are linked to EU policy priorities, specifically the green transition and the digital transformation.

Overall, the changes on the revenue side of the EU budget after 2021 have been relatively limited, especially when compared to the strong increase of EU expenditure. The expected budget revenue from the new financing instruments will be relatively low, thus they will not be sufficient to cover the repayment of the EU debt incurred in relation to the post-pandemic economic recovery of the Member States. Furthermore, the practical implantation of the new own resources may encounter difficulties in an increasingly complex international context. Considering the repayment of the common debt of the EU and the growing number of common challenges, more reforms in the system of own resources are to be expected in the following years.

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