Financing Europe - the budget conundrum

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Introduction

By Antonio Missiroli

As EU Founding Father Jean Monnet once famously said, when a policy issue becomes intractable at the European level, you have to try to change the context.

That is easier said than done, especially when the issue requires some sort of solution *before* the context can be changed – as seems to be precisely the case now in relation to the negotiations on the EU budget; i.e. the need for unanimous agreement on the Financial Perspectives for 2007-2013 among the EU-25 by early 2006 unless they resort to provisional budgetary procedures and limit EU spending to a minimum - thus penalising, in particular, the new Member States.

EU budgetary negotiations have proved increasingly tricky in recent decades. While the requirement for unanimous agreement has always been a major constraint (and all the more so with a growing number of partners sitting around the table), a further complicating factor is the strikingly narrow approach taken by an ever-growing number of countries regarding their respective contributions to - and returns from - the EU budget.

This 'book-keeping' approach, inaugurated by UK Prime Minister Margaret Thatcher (not without some justification) in the early 1980s, has now spread to most of the so-called "net contributors" to the EU budget. By the 1990s, Germany, by far the biggest of them (though not in *per capita* terms), had already started taking a tougher stance, although more in relation to its own share than to the overall size of the EU budget. Recently, others have followed suit and even widened this approach.

At the other end of the spectrum, "net beneficiaries" - not just from the budget *per se*, but especially from certain common policies - have begun digging in to defend their respective *acquis*: here, France (on the Common Agricultural Policy) and Spain (especially on the structural/cohesion funds) led the way. Lately, however, Britain has gone down the same path in its defence of the notorious 1984 "rebate". As a result, the number of "non-negotiables" on all sides has become almost unmanageable, as the Luxembourg Presidency bitterly realised in June 2005 when it tried to broker a deal.

This is why the European Policy Centre has decided - within the framework of its Integrated Working Programme on 'Political Europe' - to come forward with a detailed analysis of the current state of play before attempting to change the context of the debate.

The papers by EPC Policy Analyst Guillaume Durand and Corrado Pirzio-Biroli, formerly a long-time key player in the European

Commission, examine the background to the current EU budget negotiations, the underlying issues and the latest proposals on the table.

In doing so, they also highlight the weaknesses and contradictions of the main actors involved, and the pernicious consequences that these can have for the Union as a whole, especially in light of the goals set in the Lisbon Agenda.

Their main criticism is directed against the very idea of having “more Europe” (in terms of both expectations and demands) for less money. Guillaume Durand questions the logic of the net contributors’ approach and suggests changing the rules of the whole game. For his part, Corrado Pirzio-Biroli takes issue with some of the most recurrent arguments against the CAP and compares overall EU support for farmers with that of the US, Japan, or India. Finally, both underline the awkward position of the current UK Presidency and consider it more likely that a deal be cut under the ensuing Austrian Presidency.

What is clear is that, under the present circumstances, changing the context is quite difficult, if not impossible. The only chance to (begin to) do that would be to insert a sort of review mechanism in the 2007-2013 Financial Perspectives, i.e. a clause (or just an understanding) whereby some elements of the deal would be re-examined, say, shortly after Bulgaria’s and Romania’s accession to the Union.

This would allow the Member States to factor in also the possible implications of a successful Doha Round of world trade negotiations, starting with the phasing out of EU support for agricultural exports, seen as a precondition for a workable compromise at the World Trade Organisation. On top of that, it could reduce the size and share of CAP expenditure in the EU budget, and thus free up additional resources for other policies: not just research and innovation, as advocated especially by Sweden and Finland and more in line with the collectively agreed objectives laid down in the Lisbon Agenda; or proactive energy policy, as much a forgotten child of European integration (and a rare case of spill-over in reverse) as an urgent need for all; but also external action (including neighbourhood policy) and crisis management, for which there is strong support among the EU citizens - as opposed to the ongoing turf battles between the European Commission, Council of Ministers and European Parliament that contribute to keeping the relevant EU budgetary lines at a ridiculously low level.

That said, the controversy over reforming the CAP should not be limited merely to its impact on the EU budget (in absolute and/or relative terms), as both its supporters and critics often do. As Corrado Pirzio-Biroli underlines, the CAP has been repeatedly and substantially streamlined in recent years, although mainly in response to external pressures or budgetary crises. Its very nature, moreover, means that it cannot be modified every other year but has to provide some predictability over time.

Still, the momentum for reform should be maintained, especially since there is some margin (and some good reasons too) for further changes. However politically motivated they mostly were, and are, the arguments against the CAP have contributed to stimulating some interesting out-of-the-box analyses of the specific structure of EU agricultural spending.

These point out that the current mechanisms tend to benefit big farmers disproportionately, even in the UK.[1] In France, this contributed to the rural plebiscite against the EU "Constitution"[2], and also triggered some rethinking among the country's elites.[3] Moreover, rural development and 'green' farming are insufficiently financed; and geographically, too, the CAP rules are not exactly balanced in that they still largely favour Northern European producers.

Tackling all these issues, however, requires a radical change of context, which is exactly what is unlikely to happen as long as national governments keep haggling over their *juste retours* (fair returns) without looking at the bigger picture and the wider benefits (both immediate and strategic) that a more substantial, flexible and forward-looking EU budget could bring to all.

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Endnotes:

[1] Fiona Harvey, "*CAP 'increases inequalities between rich and poor"*, Financial Times, 18 August 2005. See also the broader analyses by John Peet, *The EU budget: A way forward*, Policy Brief, Centre for European Reform, July 2005, available at www.cer.org.uk and Phedon Nicolaides and Frank Talsma, *Financing the European Union: Options for Reform,* "Eipascope", 2/2005, pp.27-34.

[2] Two-fifths of French farmers (the smaller ones) receive together only 5% of France's CAP payments, while only 5% of French farmers (the bigger ones) receive together one-quarter thereof. See Richard Baldwin's paper, *The 'non' was also against the CAP*, available at http://www.ceps.be/wp.php?article_id=470.

[3] Cf. Laetitia Clavreul, *Comment les agriculteurs français bénéficient de la PAC*, "Le Monde", 1 juillet 2005; Marc Dufumier, *La PAC, une politique à repenser radicalement*, "Le Monde", 8 juillet 2005; Claude Allègre, *Europe, recherche, PAC: Tony Blair pose les vraies questions*, "Le Monde", 26 août 2005.

The EU budget negotiations 2005: the game, players and prospects - and where next?

By Guillaume Durand

Getting a deal on the EU budget has never been easy. Now it is more complicated than ever. The last enlargement took place on the basis of a budgetary deal reached by the EU-15 in March 1999 at the Berlin European Council. Thus, for the first time, the next Financial Perspectives (FPs), which will cover the 2007-2013 period, are being negotiated between 25 Member States, the European Commission and the European Parliament.

Since budgetary and policy priorities are intimately linked, these negotiations should be a defining moment for the enlarged European Union. So far, this has not been the case. Instead, the debate has shown a gulf between the responsibilities and ambitions that the Member States envisage for the Union, and the actual resources they are prepared to devote for it to be able to deliver. Member States have tended to stick to their traditional role; namely, to defend their status as a 'net recipient' or reduce their 'net contributions' as much as possible, rather than focus on designing forward-looking policies for the Union.

In spite of the Luxembourg Presidency's efforts, the June European Council failed to reach an agreement on the multiannual budget, adding to the impression of sclerosis conveyed by the negative outcomes of the French and Dutch referenda on the EU Constitution in May. Terming this a 'budgetary crisis' was premature, but the pressure on the Member States is now increasing. An agreement will have to be found in the early months of the Austrian Presidency if a serious crisis is indeed to be avoided.

1. Where we have come from

From annual budgets to the financial perspectives

Until 1988, the EU had only annual budgets. After a number of particularly difficult budgetary negotiations, it was decided to have multiannual package deals – initially for five years, then (since 1992) for seven.

Such agreements are thus not foreseen in the current treaties, but their adoption respects the respective powers of the institutions: the Commission presents a proposal, which needs the approval of both the Council of Ministers (deciding by unanimity) and the European Parliament. The Inter-Institutional Agreement of 6 May 1999 regulates

decision-making. If no agreement is reached under the procedure it lays down, any institution could 'denounce' it. In that case, there would be no medium-term planning and the budget would be decided on an annual basis, as foreseen by Treaty provisions on the budget.

The initial showdown: the Commission proposal vs. the letter of the 'six'

The Financial Perspectives have met their central objectives of providing a stable operational framework for EU policies and defusing traditionally time- and energy-consuming rows on the annual budget. They have also enhanced the visibility and political relevance of a process that establishes a framework for all EU policies for up to seven years.

When the Commission took the initiative in February 2004[1] and proposed an budget of 1.24% of Gross National Income (see Table 1 in annex), a number of Member States had already made it clear that this was too high a ceiling. In particular, Germany, France, the United Kingdom, the Netherlands, Austria and Sweden – all net contributors, although by no means the only ones – had issued a joint letter on 15 December 2003 demanding that "expenditure during the next financial perspective should…be stabilised around current expenditure levels, and should not exceed 1.0 % of GNI".

Agreeing at all costs: the Luxembourg attempt

Negotiations in the Council then went on for almost a year and a half. At the end of 2004, the Dutch Presidency reported widely different views: under each budgetary heading, there were a number of alternative proposals to the Commission's plan. Each of these "building blocks" differed both in terms of the overall ceiling and internal priorities and was supported by groups of Member States.

Unsurprisingly, this method exposed a very large gap between the maximalist and minimalist positions (see Table 1, Column 3): adding up the most expensive options in each of the 'building blocks' gives a total of 1,050 billion euros (1.27% of EU GNI), compared with just 694 billion euros (or 0.85% of EU GNI) taking the lowest ceilings proposed under each heading.

The Luxembourg Presidency was successful in bringing national positions much closer together, but desperate eleventh-hour efforts by Prime Minister Jean-Claude Juncker to broker a compromise failed at the European Council of 16-17 June 2005. The proposed deal, based on a low 1.04% of GNI, was eventually rejected – albeit for different reasons - by six Member States: the UK, Sweden, the Netherlands, Finland, Italy and Spain. In the meantime, the European Parliament had

adopted a resolution on 8 June 2005 advocating a significantly higher budget of 1.18% of GNI.[2]

2. What prospects for agreement?

Difficult timing

It is widely expected that no agreement will be reached under the UK Presidency (i.e. by the end of 2005), not least because the contentious issue of the UK rebate puts London in an awkward position. Indeed, it is difficult to see how the Presidency could be an honest broker while defending a rebate that is currently worth some 5 billion euros a year.

However, some progress could be made through informal meetings so as to prepare the ground for a quick wrap-up under the Austrian Presidency, which takes over in January 2006. From then, the political pressure will steadily increase because any agreement reached after March 2006 would seriously hamper the Union's ability to implement its programmes in due time, in particular in relation to structural funds. Indeed, these programmes are multiannual and require preparations and local partnerships involving many public and private stakeholders. Given the vast sums of money at stake, the decision-making process also entails a detailed review of the projects to be funded. This would hurt the new Member States most, as it could lead to significant financial losses since parts of the funds they are already counting on have yet to be formally decided upon. Any blocking strategy would thus antagonise a large block of Member States.

Past financial negotiations have always been concluded at the very last minute and there was no reason to believe that this would change in a larger, more diverse Union. After the failure of the French and Dutch referenda on the Constitution, however, the Union can hardly afford another crisis. The most likely (as well as desirable) scenario, therefore, is an agreement under the Austrian Presidency.

The current state of play

The last compromise proposal put forward by the Luxembourg Presidency envisaged a budget that was 15% smaller than the original Commission proposal (see Table 3). Significant cuts were made in the overall agricultural budget (-7%), but agricultural payments were almost as high as in the Commission proposal, while rural development funding was severely reduced (-20%). Under the sustainable growth heading, the draft compromise was even more conservative and the figures were very close to the baseline scenario in our tables, which shows what the FPs for 2007-2013 would look like if their relative size (as a percentage of GDP) and the share-out of funds between policy areas were left unchanged.

Compared with the Commission proposal, structural funds were reduced by 11%. This was done by slashing the money available for relatively richer Member States - which explains the opposition of Spain and Italy to the final deal. More spectacularly, the large increase proposed by the Commission for competitiveness (i.e. research, Trans-European Networks, education, training and social policy) was almost entirely discarded. For all the talk about Lisbon and competitiveness, most Member States have not proved willing to put their money where their mouths are, prompting severe criticism from countries like Finland and Sweden when they rejected the compromise proposed by Luxembourg.

Although expenditure under heading 3 (citizenship, security, justice - covering justice and home affairs, but also culture, youth and consumer protection) makes up a much smaller share of the overall budget, it also suffered severe cuts. The amount proposed by the Luxembourg Presidency on 15 June was almost as low as the minimalist option outline in the building blocks of 6 December 2004 - and even lower than the baseline scenario. This is surprising, given the high profile of security and justice issues in the current political debate. Similarly, 'citizenship' covers such well-known and visible programmes as Erasmus and Socrates. Sacrificing these policies at a time when all European leaders talk about "reconnecting Europe with its citizens" seems hard to justify.

What will the European Parliament do?

In line with the Inter-institutional Agreement of 6 May 1999, which laid down the Financial Perspectives currently in force, the European Parliament will need to approve the new FPs. Its own proposal of 8 June 2005 is much closer to the original Commission blueprint than to the compromise presented by the Luxembourg Presidency (compare columns 1, 4 and 5 in the three tables annexed).

In essence, the Parliament endorsed the Commission's priorities, notably the strong focus on competitiveness, but shaved some 50 billion euros off the overall budget by advocating less radical changes. The gap between this and the figures discussed by the Council of Ministers amounts to 110 billion euros, with competitiveness, cohesion and rural development accounting respectively for some 50, 30 and 20 billion of this.

The Parliament's real power in these negotiations is, in practice, fairly limited. With the clock ticking and the need for a deal becoming increasingly urgent, it is hard to see how, from now on, the Parliament could significantly influence the final deal. Blocking whatever is eventually agreed by the Council of Ministers is a very blunt instrument, and hence an unlikely option: on the face of it, most MEPs would probably prefer a mediocre budget deal to a crisis that would only add to the Union's post-referenda political woes.

A comparison between columns 2 and 5 in the annexed tables shows that the last proposal put forward by the Luxembourg Presidency is extremely conservative. Yet even the Commission acknowledges that it should be used as a working basis for the negotiations.

From now on, every Member State, in particular those which explicitly opposed the final compromise, will try to extract a few last-minute concessions from their partners. However, apart from these rather marginal changes, the eventual agreement is likely roughly to follow the lines of the draft debated by the European Council on 16-17 June. This would merely confirm that national leaders prefer to be seen battling for their national interests until the very last minute – if only, as Budget Commissioner Dalia Grybauskaité said, referring to UK Prime Minister Tony Blair, "to restore (his) internal image". Hence, the parameters of the debate and of the final solution are largely known, but the show is likely to go on for at least six more months.

3. Back to the future: re-thinking the EU budget

Flexibility and reactivity

Just as with any budget, the Financial Perspectives do not come from nowhere and do not start from scratch: they are largely a legacy of the past. In the EU, however, there is even less flexibility than is normally the case, and this makes the budgeting process ever more problematic.

First, the requirement for unanimous agreement acts as a powerful brake on any reform drive: vested interests are easily protected, while any innovative policy needs to win the support of all 25 EU Member States. The bargaining power of defenders of the status quo is thus very strong and, resources being limited, trade-offs tend to favour a conservative approach - which is precisely what has happened in the current round of negotiations.

As demonstrated during the Convention which drafted the EU Constitution, qualified majority voting on financial matters is not (yet) an acceptable solution for a number of Member States. It remains to be seen whether there is a 'third way' between the current procedures and 'pure' qualified majority. The idea of a 'super-qualified majority', touted by many members of the Convention, was eventually rejected and a much weaker *'passerelle'* mechanism was introduced, whereby Member States can unanimously decide to agree the budget by qualified majority. In any case, loosening the decision-making rules would undeniably favour much-needed changes.

In addition, the EU's financial planning is unique both in covering a seven-year period and in being mandatory: this leads to a damaging lack of flexibility. In its original proposal, the Commission

recommended loosening up the financial straitjacket of the FPs by introducing some margin for manoeuvre. Since it is difficult to assess the Union's needs in 2013 now, a dose of flexibility was only reasonable. However, Member States almost unanimously rejected the proposed measures.

Making the Union's budget more flexible and reactive should go hand in hand with increased political drive and accountability. As things stand, the new Parliament and Commission elected in 2009 will be left with implementing FPs they had no influence over, and preparing and ensuring the adoption of the next FPs, which they will not implement. This situation needs to be changed and the European Parliament made a valuable proposal to that end: the new FPs would cover five years instead of seven, and the Commission and Parliament elected in 2009 would prepare (and largely implement) the next FPs covering the years 2012-2016.

There is no legal obstacle to this move. Indeed, the first FPs - the "Delors-1 package" – lasted this long, covering the 1988-1992 period. In addition, the "Multiannual Financial Frameworks" (MFF) provided for in the draft Constitutional Treaty, which would have replaced the *ad hoc* Financial Perspectives, would have covered five years.

Although it has not (yet) been ratified, this treaty was signed by all Member States. It may not be an option any more at this stage in the negotiations, but a strong "mid-term review" by 2010 should be considered as a first step towards the synchronisation of the political and financial agendas. Such a review should apply to the whole budget, and not only to agricultural expenditure.

Autonomy

The notion of 'net contributions' is another permanent bone of contention in budgetary talks. It is a very shaky and artificial concept that prompts many objections.[3] It is flawed in principle because it reduces the benefits of Union membership to a zero-sum budgetary game, thereby undermining both the principle of solidarity and the real value of common policies. It is also flawed in economic terms because calculations are based on highly disputable, arbitrary assumptions as to the allocation of expenditure and revenue to the Member States, the actual impact of expenditure (rather absurdly considered homogeneous in standard computations), and the spill-over effects (usually disregarded).

No matter how inconsistent it may be, however, the notion of 'net contributions' has come to dominate the political debate, and Member States tend to think primarily in terms of a *'juste retour'* (getting a fair return or, to borrow Margaret Thatcher's famous phrase, "getting their money back"), rather than in broader policy terms.

The best way to overcome all this would be to equip the Union with real "own resources" - as foreseen by the Treaties (Article 269 TEC) since the very beginning of the Community. The steady decline in the share of the budget funded by "traditional own resources" (customs duties and agricultural levies), resulting from lower customs tariffs and the growth in the size of the overall budget, will not be reversed. The fact that the EU budget is now mainly financed through a GNI-based contribution (75% in 2004) is, however, fairly recent. The system has practical advantages, but is severely flawed in terms of accountability and visibility: European citizens have no idea how much they pay for the Union.

The idea of an "EU tax" is still anathema to many, but would nevertheless be well worth pursuing. It would give the Union the much-needed financial autonomy prescribed by the Treaties; defuse the vain but permanent tensions over "rebates", "fair return" and "net contributions"; allow the debate to focus on real political priorities; and enhance political accountability.

Technically, much work has already been done on this issue. In particular, the European Commission presented its report on the operation of the own resources system[4] in July 2004. This report contained two main proposals: a "generalised correction mechanism" designed to replace the existing UK rebate and concrete proposals for the future financing of the budget. Since July 2004, however, the issue of net contributions has dominated the political agenda and the Commission proposals on own resources have barely been discussed.

Concretely, the Commission advocates "the budgetary neutral introduction of a new own resource representing half of the budget". This EU tax could be based either on energy consumption, corporate income or a share of Value Added Tax receipts. In any case, any such system would not apply before the FPs for 2014 onwards. In the meantime, the Commission should relaunch its proposal and highlight the potential benefits for specific EU policies - be it the internal market (the allocation of a portion of corporate tax revenues to the EU would need to go hand in hand with the harmonisation of the corporate tax base that European companies are calling for), or environmental policy (a tax on CO_2 emissions could significantly contribute to the achievement of the Kyoto objectives).

Confronting the taboos

More flexibility, more autonomy and a much clearer link with the political calendar should contribute to a more dynamic and forward-looking budgetary debate. Discussions should be based on the notions of added value and subsidiarity. Taking a fresh look at the budget through this prism would allow Member States to reap the benefits of acting together where there are obvious, vast and untapped economies of scale, while keeping in mind that a degree of solidarity is

needed for the whole European project to be sustainable. Innovation policy and security policy should be the first candidates to pass this test.

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Endnotes:

[1] Building our common Future – Policy challenges and Budgetary means of the Enlarged Union 2007-2013, COM (2004) 101: http://europa.eu.int/eur-lex/en/com/cnc/2004/com2004_0101en02.pdf

[2] European Parliament resolution on Policy Challenges and Budgetary Means of the enlarged Union 2007-2013 (2004/2209(INI)):
http://www.europarl.eu.int/comparl/tempcom/finp/report/p6_ta-prov(2005)0224_en.doc

[3] For a short but comprehensive refutation of the 'net contribution' concept, see for instance: A fair solution to the UK rebate conundrum, Ideas Factory Europe, July 2004: PP 5-9. For longer developments on the subject: European Budget - The poisonous budget rebate debate (Notre Europe):
http://www.notre-europe.asso.fr/article.php3?id_article=808&lang=fr

[4] COM/2004/0505 final of 14 July 2004. Note that this report follows a request by the Council which, in its decision on own resources (2000/597) asked the Commission to "undertake, before 1 January 2006, a general review of the own resources system, accompanied, if necessary, by appropriate proposals, in the light of all relevant factors, including the effects of enlargement on the financing of the budget, the possibility of modifying the structure of the own resources by creating new autonomous own resources and the correction of budgetary imbalances granted to the United Kingdom as well as the granting to Austria, Germany, the Netherlands and Sweden of the reduction pursuant to Article 5(1)".

See annex (next page) for the various scenarios which have been proposed for the Financial Perspectives for 2007-2013.

ANNEX

Table 1	1	2	3		4	5
Commitment appropriations (1) (in million €)	Commission's original proposal (2)	Baseline: if status quo maintained (3)	Council scenarios 6.12.2004		European Parliament proposal 8.6.2005 (6)	Final Luxembourg proposal 15.6.2005 (7)
			Minimum (4)	Maximum (5)		
1. Sustainable growth	477,665	368,100	290,000	488,000	459,035	378,518
1a. Competitiveness	*132,755*	*68,008*	*60,000*	*133,000*	*120,563*	*72,010*
1b. Cohesion	*344,910*	*300,092*	*190,000*	*355,000*	*338,472*	*306,508*
2. Natural resources	404,655	433,339	330,000	415,000	396,248	377,801
2a. Agricultural payments	*301,074*	*338,339*	-	-	*293,105*	*295,105*
2b. Other natural resources	*103,581*	*95,000*	-	-	*103,143*	*82,696*
3. Citizenship, security, justice	18,505	10,684	10,000	20,000	19,437	10,055
4. EU as a global partner (7)	95,590	86,892	80,000	99,000	-	-
4a. Excluding EDF	-	-	*52,000*	*77,000*	*70,697*	*50,010*
5. Administration (8)	28,620	26,581	24,000	28,000	28,620	-
5a. All administrative costs	*57,700*	-	-	-	*54,765*	*50,300*
Compensation	0	0	0	0	800	0
Total	1,025,035	925,595	694,000	1,050,000	974,837	866,684
As a percentage of GNI	1.24%	1.12%	0.85%	1.27%	1.18%	1.05%

Table 2	1	2	3		4	5
Commitment appropriations (1) (in per cent)	Commission's original proposal (2)	Baseline: scenario if status quo maintained (3)	Council scenarios 6.12.2004		European Parliament proposal 8.6.2005 (6)	Final Luxembourg proposal 15.6.2005 (7)
			Minimum (4)	Maximum (5)		
1. Sustainable growth	46.6%	39.8%	36.0%	46.5%	47.1%	43.7%
1a. Competitiveness	*13.0%*	*7.3%*	*8.6%*	*12.7%*	*12.4%*	*8.3%*
1b. Cohesion	*33.6%*	*32.4%*	*27.4%*	*33.8%*	*34.7%*	*35.4%*
2. Natural resources	39.5%	46.8%	47.6%	39.5%	40.6%	43.6%
2a. Agricultural payments	*29.4%*	*36.6%*	-	-	*30.1%*	*34.0%*
2b. Other natural resources	*10.1%*	*10.3%*	-	-	*10.6%*	*9.5%*
3. Citizenship, security, justice	1.8%	1.2%	1.4%	1.9%	2.0%	1.2%
4. EU as a global partner (7)	9.3%	9.4%	11.5%	9.4%	-	-
4a. Excluding EDF	-	-	*7.5%*	*7.3%*	*7.3%*	*5.8%*
5. Administration (8)	2.8%	2.9%	3.5%	2.7%	2.9%	-
5a. All administrative costs	*5.6%*	-	-	-	*5.6%*	*5.8%*
Compensation	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%
Total	100%	100%	100%	100%	100%	100%

Table 3	1	2	3		4	5
Commitment appropriations (1) (COM original = 100)	Commission's original proposal (2)	Baseline: if status quo maintained (3)	Council scenarios 6.12.2004		European Parliament proposal 8.6.2005 (6)	Final Luxembourg proposal 15.6.2005 (7)
			Minimum (4)	Maximum (5)		
1. Sustainable growth	100	77	52	102	96	79
1a. Competitiveness	*100*	*51*	*45*	*100*	*91*	*54*
1b. Cohesion	*100*	*87*	*55*	*103*	*98*	*89*
2. Natural resources	100	107	82	103	98	93
2a. Agricultural payments	*100*	*112*	-	-	*97*	*98*
2b. Other natural resources	*100*	*92*	-	-	*100*	*80*
3. Citizenship, security, justice	100	58	54	108	105	54
4. EU as a global partner (7)	100	91	84	104	-	-
5. Administration (8)	100	93	84	98	-	-
5a. All administrative costs	*100*	-	-	-	*95*	*87*
Compensation	-	-	-	-	-	
Total	100	90	68	102	95	85

Source: European Policy Centre 2005

Explanatory notes for tables:

(1) The budget distinguishes between commitments for appropriations, i.e. the money that can be committed by the EU to various kinds of expenditures in any given budgetary year, and commitments for payments, i.e. the money that can be actually paid that year.

(2) Proposals put forward by the Commission in its Communication of February 2004 (see full reference in endnote 1)

(3) These notional figures show what a continuation of the 2004 budget would look like. They allow for economic growth, thus keeping the overall budget stable as a share of GNI.

(4) These figures are based on the lowest figures for the building blocks outlined in the Progress Report of the Dutch Presidency of 6 December 2004 (Council document 15632/04 – CADREFIN 155)

(5) These figures are based on the highest figures for the buildings blocks outlined in the document mentioned in (3)

(6) EP resolution of 8 June 2005 (see full reference in footnote 2)

(7) Note of the Luxembourg Presidency of 15 June 2005 to the European Council (Council document 10090/05 – CADREFIN 130). Some further amendments to this text were made at the European Council of 16-17 June in an attempt to "bribe" opponents to a deal into agreeing. The document of 15 June 2005 is nevertheless widely regarded as the basis for further negotiations.

(8) A comparison across the board is impossible because, in the course of negotiations, the Council made it clear that it did not want to include the European Development Fund (EDF) in the budget as was proposed by the Commission.

(9) In line with the principle of "activity-based budgeting", the Commission had distributed its own administrative expenditures under the respective policy budgetary headings in its original proposal. To keep a closer eye on the Commission's administrative expenditures, the Council has decided to keep all administrative expenditures together.

CAPping the budget? Agricultural policy and the financial perspectives 2007-2013

By Corrado Pirzio-Biroli

In June 2005, EU leaders unsurprisingly failed to reach agreement on any major aspect of the New Financial Perspectives (NFPs) for the Union's 2007-20013 budget: spending, benefits and contribution levels. Why is this so?

I. Where we stand

The so-called "net beneficiaries"[1] do not want to lose their (traditional or expected) benefits. The so-called "net contributors"[2] want to pay less. The UK does not want to give up its budget rebate (which was obtained in very different circumstances by the then Prime Minister Margaret Thatcher in 1984). And France wants to cap EU budget payments, leaving the Common Agricultural Policy as the biggest heading.

Without capping the UK budgetary rebate, or replacing it with a more balanced rebate system for all net contributors, enlargement would boost the contributions of all the richer Member States except the UK (which would see its rebate double in value), and curtail the maximum allowable benefits of the poorer (and, in particular, the new) members. Germany's contribution has already reached €21.3 billion in 2005 (about a quarter of the EU budget), whereas the UK's (a country richer today than Germany) is only €12.3 billion.

Although the EU budget accounts for only a tiny proportion of the Member States' public expenditure and has no relation to the economic benefits of EU membership, the net balance of payments to (and receipts from) the EU budget has become a growing obsession of the richer Member States.

There are three reasons for this. The first is the discipline of the so-called "Maastricht criteria": if the Member States have to apply them, so should *(mutatis mutandis)* the EU budget. Secondly, for most Member States, the pursuit of economic growth has often become more important or urgent than social cohesion. Thirdly, the solidarity concept - which is part and parcel of Europe's socio-economic model and an essential component of the Single Market - enjoys even less support among the EU's paymasters.

These are the main factors that have led senior national officials increasingly to mimic those of the UK, which started all this in the late Seventies, and sit in EU committees armed with pocket calculators before taking a position on any EU policy item with budgetary

implications. It has also led EU Heads of State and Government to neglect their main policy responsibilities and emphasise prestige over substance. The arguments made by government officials are being increasingly dictated by narrowly defined self-interest rather than collective advantage, regardless of the merits of each case.

Take, for instance, the 20-year-old UK budget rebate. Tony Blair did not want to renegotiate it, although the last enlargement will automatically increase it from €4.6 billion to €8.9 billion at the expense of the poorer countries which have just joined the Union. Such an increase means that the UK - one of the richest EU countries and one of the biggest supporters of a speedy big-bang enlargement - would be the only EU-15 country exempt from financing accession.

In turn, Blair's hint that he might agree to put the rebate on the table in exchange for further CAP reform was too clever by half, not to say hypocritical. He must have been aware that: a) he signed the unanimous October 2002 Brussels agreement to freeze farm spending at €43 billion per year in real terms until 2013; b) changing this would require, again, an unlikely unanimous agreement; and c) the mere mention of a further cut in farm spending weakens the EU's position in the World Trade Organisation (a position that has become far stronger today than that of the US).

He must have also known that CAP reforms cannot be produced on an assembly line without the required periods of rest and without drawing the lessons from previous restructuring efforts. If there was still a separate British agricultural policy, and a UK commitment to freezing national subsidies up to 2013, would he have dared to double-cross his farmers by advancing the deadline?

One cannot escape the conclusion that Blair's message actually was "hands off the UK rebate". But, as this amounted to a slap in the face to the newcomers, whose benefits from the EU depend on a rapid agreement on the NFPs, the UK had to backtrack. Contradicting Blair, the UK Minister for the Environment, Food and Rural Affairs[3] Margaret Beckett declared in July that the UK was not expecting an overhaul of agricultural subsidies to come into force before 2014. And the European Commissioner for Agriculture and Rural Development Mariann Fisher-Boel wondered whether putting EU farm spending back on the table was "just a gimmick or game playing". One cannot indeed describe Blair's fresh push for farm reform, which lacked any detailed concept or blueprint, any differently.[4]

Although the compromise proposal tabled by the Luxembourg Presidency[5] was reasonable as regards the UK rebate (maintaining the €4.6 billion status quo), Blair rejected it. It is unlikely that a different agreement can be reached under the UK Presidency, so the EU will almost certainly have to wait for next year's European Council under Austria's chairmanship.

II. Assessing the debate

The NFPs blueprint put forward by the Prodi Commission took the members of the European Council at their word by using the political priorities previously set by the Council as a basis and suggesting appropriate new budget headings. It thus organised the budget around *goals* rather than *instruments*, and proposed the financial resources to implement them.[6] In doing so, it underlined the importance of existing common policies to achieve the Council's priorities and objectives in areas such as as cohesion, solidarity, agriculture, fisheries, transportation, and the EU's role in the world.

The Prodi blueprint strictly adhered to the following policy priorities established in recent years by the European Council:

- those that are also part of the so-called Lisbon Strategy on competitiveness, growth and employment;
- the agreement of October 2002 to freeze farm spending; and
- the largest EU accession wave in history.

Three priorities were highlighted: boosting sustainable economic growth, including social cohesion measures (48.5% of total expenditure) and the sustainable management and preservation of natural resources (i.e. agriculture plus environment: 36.7%); making Europe a strong and coherent partner in the world (9.9%); and guaranteeing freedom, justice and security to EU citizens (2.3%).

According to the Commission, this required annual appropriations at the end of the period of €158.450 billion (at 2004 prices), keeping payments within the old 'own resources' ceiling of 1.24% of GNI despite successive enlargements.

As the blueprint was presented in times of budgetary rigour, as applicable to the Member States as well as to the EU proper, the Commission proposed only those expenditure increases that were necessary to meet commitments made by the Council or essential to achieve EU objectives set by it. Accordingly, the ceiling for payments up to 2013 was actually only about 0.10% of GNI higher than that for Agenda 2000 (both adjusted for enlargement). This is not much considering the new policy commitments made by the Council since 1999. Since the share of agriculture would decrease from 45% of EU commitments in 2006 (as compared to 60% in 1989) to less than 35% in 2013, new policies would take an increasing share of the EU budget.

The Commission was, of course, aware that, even if the Council agreed to follow such a growth-supportive approach to the NFPs, it would not make a great deal of difference to the Union's growth prospects because of the tiny size of the EU budget compared to that of

the combined national budgets (2%). However, it would be difficult to deny that the Prodi Commission blueprint made sense and was consistent with the Lisbon Strategy commitments.

Unfortunately, however, it fell on deaf ears, in particular because six Member States (the “gang of six” main net contributors) arbitrarily argued that the ceiling for the EU’s ‘own resources’ should be 1% of GNI until 2013. In order to justify their claim that the Commission had gone overboard, their criticism emphasised cumulative *commitments* for the whole 2007-2013 period instead of annual *payments*, as was the case for the budget ceiling agreed at Fontainebleau in 1984.

It must be recalled that three of these Member States (Germany, France and the UK) were present 20 years ago when the Council agreed to set the budgetary limit at 1.27% of GDP (or 1.24% of GNI) for an EU with only ten Member States. Enlargement was not on the agenda then. Is it conceivable that the “gang of six” was unaware that enlargement to the East had substantial financial implications? The accession of 15 (soon 17) more countries over the last decade, most of who are major net recipients of Community financing, inevitably means major expenditures by - but only minor revenues for - the EU budget.

Moreover, all members of the “gang of six” had only recently signed up to a freeze in agricultural market spending up to 2013, the framework that became the basis for the biggest agricultural reform in the EU’s history. All of them accepted that it would not be possible to “decouple” EU financial support from agricultural production in order to make it more market-oriented and less trade-distortive without guaranteeing historical support levels. And most of them favoured a shift of CAP resources towards rural development.

They must have been aware that their 1% GNI ceiling demand betrayed prior commitments, and that the Brussels 2002 framework for agricultural support until 2013 could not be respected with such a ceiling. It would require a cut in market expenditure below the freeze level; furthermore, it would leave no trace of the agreed shift from market to rural support. Instead of expanding, rural development policy would shrink so that spending on environmental measures, animal welfare and food quality - all affecting the sustainability of agricultural production - would suffer.

III. Capping or scrapping the CAP?

As regards the CAP's share of the EU budget, many critics argue that even halving it since the early 1980s has left it too large. But is this so and, if so, what does this mean?

There are few EU common policies and their budgetary impact varies widely. In several areas - such as competition, the internal market,

external trade or the environment - the EU's task is only to ensure a fair and effective regulatory framework for action. This does not involve any significant expenditure. In other areas - such as research and transportation - the Community budget is meant to complement, stimulate or catalyse the delivery of common policy objectives. In some areas - such as agriculture and fisheries - the Member States have agreed to pool their resources at the EU level for various reasons: to reduce pressure on national budgets; to avoid the costs of competing national policies; to ensure comparable support to producers in order to avoid distortions which could disrupt the free movement of goods; or, more recently, to promote coordinated conservation.

Agriculture represents the largest item (soon to be the second largest, after the structural funds) in the EU budget, not just because the Member States wanted it to be the only EU policy funded almost exclusively out of the Union budget (rather than the individual budgets of the Member States), but also because they failed to produce other major common policies with substantial budgetary implications and to shift financial means from the national to the EU level.

For instance, if they had created a common defence policy in order to streamline their defence expenditure and make their collective defence capabilities more effective, the relevant defence heading could have become the largest item of the EU budget.[7] The same holds true for R&D expenditure: in Europe, it accounts for about 2% of public expenditure - over four times more than expenditure on agriculture (0.4% of GDP) - but, unlike farming, it has largely remained outside the EU budget.

There are four ways to reduce the share of agricultural spending in the EU budget: 1) by increasing support for other existing policies; 2) by creating new common policies; 3) by cutting agricultural outlays; or 4) by a combination of two or more of these measures. Yet there is little enthusiasm among the Member States for any such course of action except for cutting the CAP, which some of them would be glad to scrap altogether.

Some (half-rhetorical) questions need to be raised. Can we honestly argue that the EU and its Member States are still spending too much on agriculture and rural development after the steady rise in public spending by the Member States over the last few years, while agricultural expenditure has decreased (in real terms as well as per farm)? Is it too much to devote 1% of total public expenditure (the EU plus the Member States) to EU farmers, who represent on average some 5% of the population (20% in Poland)? Is it too much to devote 0.43% of GDP (0.66% in 1992) to that sector if a) the US does about the same (and with only one sixth of Europe’s farmers); b) countries such as India devote some 2.5% of their GDP to it; and c) virtually all countries in the world have a national agricultural policy?

How many people are aware of the linkages between agriculture, rural development, commerce, tourism, the food industry, infrastructural costs and overall employment levels? What would, for instance, be the budgetary costs of catering for the additional urban or suburban dwellers that would be produced by accelerated rural desertification? Wouldn't an end to the CAP result in contradictory policies by the Member States, causing the collapse of the internal market? Wouldn't it reduce European farm production to such an extent as to trigger a rise in world prices, with serious consequences also for food-importing developing countries? And wouldn't it end up benefiting - besides large US, Canadian, Australian and New Zealand farmers - mainly the *latifundistas* (large land-owners) of Latin America who invest their profits on Wall Street?

The CAP scrappers do not seem to care for the answers to such questions. This does not mean that the CAP reform process should stop. The CAP must continue to evolve. But sustainable agriculture remains an asset to be cherished, and one that will continue to require adequate support. This will, in time, need to be concentrated on those who need it most because they cannot compete without it, especially in the domain of rural development and sustainable agriculture. As for the most competitive EU farmers, they can expect lower financial support over time, which will allow for substantial reductions in overall CAP expenditure.

IV. Conclusions

While everyone agrees that the EU budget should apply the same rigour as national (and regional) budgets, certain Member States want to reduce the already limited significance of the EU budget (which is more than 40 times less than Member States' public expenditure and 20 times less than the relevant US federal budget). The net political result of such an approach, however, is a reduction of existing EU policies, whether they involve significant EU budget outlays or not.

Most Member States are aware that the levels of financing for the structural funds and agriculture are necessary within the context of Europe's socio-economic "model", but would like to do more of that within the framework of their national budgets rather than through the EU budget. Where the share of co-financing is already high (structural funds), a number of Member States are pushing for cuts. Where there is no co-financing (the CAP, pillar one), a number of Member States wants to introduce it (at, say, 20%), as is the case for the rural development pillar of the CAP. Since overall CAP expenditure would remain the same, this would primarily mean that the EU budget would carry less of it.

Motivations for such a move differ. There are those who would like to change the payments-receipts balance to their advantage by reducing

the net benefits of others (most prominently the British as opposed to the French). But several Member States favour (or fear) a move towards co-financing as a first step towards the "renationalisation" of the CAP.

On budgetary matters, the Member States have adopted double standards regarding the EU and national budgets respectively. Nationally, they first look at objectives and only then at means, eventually adjusting the objectives to the means available. At the EU level, only the net beneficiaries look at objectives first. The net contributors, instead, tend to adopt an approach whereby they try to fix an arbitrary expenditure ceiling before they agree to discuss which policy objectives can fit within that ceiling. As a result, diversification of EU budgetary expenditure would therefore be obtained by cutting existing common policies, in particular the CAP, instead of increasing support for growth - and employment.

Unfortunately, the current discussions among EU leaders offer no indication that they are prepared to abandon a narrow budgetary approach in favour of a political leadership more responsive to the main concerns of EU citizens, and therefore more likely to strengthen public support for a united Europe.

As long as they believe that only national policy can produce votes, and that blaming the EU for domestic problems can help to achieve that end, they risk missing the opportunity to take advantage of the EU level as an additional instrument of domestic prosperity and international influence.

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Endnotes:

[1] Portugal (3.5%), Greece (2.22%), Ireland (1.6%) and Spain (1.21%). The new Member States are also net beneficiaries, but cannot compare their position at this early stage of their membership.

[2] Currently (2003), the net contributions of the Member States to the EU budget in terms of Gross National Income (GNI) are: the Netherlands (-0.43%), Sweden (-0.36%), Germany (-0.35%), Belgium (-0.28%), UK (-0.16% after rebate), Austria (-0.15%), France (-0.12%), and Denmark (-0.11%).

[3] Note the lack of mention of "agriculture" in the ministerial title.

[4] Incidentally, if farm spending were to be reduced after 2014, the simplest - and most socially acceptable - way to do so would be to cap the subsidies per farm, a proposal made by Commissioner Fischler that the UK (with the support of Germany) opposed in 2003.

[5] PM Junker proposed to limit annual commitments to 1.06-1.09% of GNI (€ 869-903 billion) against the Commission proposal of 1.24% of GNI (equivalent to 1.14% of GNI in terms of payments) or € 1025 billion, and to freeze the UK budget rebate at its current level.

[6] The initial draft proposal, based on a concept by Prof. Andre Sapir, aimed at facilitating, *inter alia*, the eventual abolition of the CAP by eliminating the relevant budget heading and reapportioning it in bits and pieces among different policy goals (headings) such as peace, freedom and citizenship, sustainable development, and solidarity. Sapir's proposal to create three funds (for growth, convergence and restructuring respectively) could lead to reducing the relevance of the EU and its budget, in particular as regards the common policies and the solidarity aspects , both of which should, according to him, be given back to the Member States. It nevertheless played a role in the early stages of the Commission's work on NFPs.

[7] Today, defence expenditure by the EU-15 alone amounts to € 160 billion a year, i.e. nearly four times that of the CAP. Moreover, part of it is wasted due to the additional supply costs deriving from defence market fragmentation, duplications due to lack of coordination, and weak capacity for joint action due to incompatible communication and other defence equipment standards.