SPEECH BY CHRISTOPHER TUGENDHAT, COMMISSIONER OF THE EUROPEAN COMMUNITIES, TO THE INSTITUTE FOR WORLD ECONOMIC RESEARCH, HAMBURG, MONDAY, 3rd MARCH, 1980 at 17.00 H

"SOME THOUGHTS ON THE EUROPEAN COMMUNITIES BUDGET"

It gives me great pleasure to come to Hamburg and talk to you today, not only because I always enjoy my visits to the Federal Republic, but also because there are good reasons why it is, I believe, appropriate for me to make this particular speech in Germany. A speech about the Community Budget is especially relevant in the most economically successful Member State of the Community, and the one which sets an example of economic stability to us all. I want therefore to share with you some thoughts about this Budget as it is now, and how it may develop in the future.

The Budget of the European Communities has in the past tended to be seen as something of a political backwater, the preserve of specialists and lawyers who have succeeded in mastering its very technical procedures.

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However, since I took over responsibility for this portfolio in the Commission at the beginning of 1977 it has moved from the political periphery to the centre of the stage. There are several reasons for this change.

Firstly, it has become apparent that the Budget is the point at which the Council of Ministers and the European Parliament clash, and at which in important respects their powers are defined. Two of the last three budgets have been subjects of dispute between these two institutions, which together constitute the Budgetary Authority, and the differences over the 1980 Budget proved so intractable that the Parliament rejected it altogether.

On both occasions the dispute arose out of a fundamental disagreement about the balance of the Budget. Throughout the Community there is growing unease about the pattern of Community expenditure, and particularly about the way in which it is dominated by agriculture, which in 1979 accounted for some 70% of the total. This unease has been strongly expressed in the Parliament, and is the second main reason why the Budget is now attracting so much attention.

The third is the approach of a financial crisis. It seems likely that at some point in 1981 or 1982 the Community's financial "Own Resources" will no longer be sufficient. When that happens member states will have to face up to some difficult problems involving both income and expenditure if the Community is to avoid a political crisis as well.

Finally there is the problem of the unequal way in which the costs and benefits of the Community Budget are distributed among the member states. This is a source of particular and understandable concern in Britain. It is of vital importance for the Community that a satisfactory solution to the British problem should be found with a minimum of delay, but that is a subject for another speech and, though some of the things I have to say are relevant to this problem, it is not the focus of my remarks this evening.

I THE BUDGET AND THE INSTITUTIONS

I said that the Community Budget involves fundamental political and institutional issues, and I would summarise these issues under 2 headings, (a) capacity to increase or curb expenditure and (b) legal significance of budgetary powers. Before discussing these points, however, I should explain briefly how the budget procedure works.

As with almost all Community measures, it is the Commission which initiates the procedure by drawing up the basic budget proposal (the "Preliminary Draft Budget"). This is then presented to the Budgetary Authority, which consists of both the European Parliament and the Council of Ministers, and follows a procedure whose sequence and deadlines are laid down in some detail in Article 203 of the Treaty of Rome. The budget is given alternate readings by the two institutions, up to two readings each, beginning with the Council. It is, however, the President of the Parliament alone who, after the final reading by Parliament, can declare the budget adopted or rejected.

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(a) <u>Capacity to alter expenditure appropriations</u>

The respective powers of the European Parliament and the Council of Ministers to alter expenditure appropriations in the Budget differ significantly. They are governed by two key factors: the distinction in the budget between "obligatory" and "non-obligatory" expenditure, and the existence of a "maximum rate of increase" of non-obligatory expenditure.

The unusual and rather artificial distinction between obligatory and non-obligatory expenditure arises from differences in the procedures laid down in the Treaty for approval of expenditure "necessarily resulting from this Treaty or from acts adopted in accordance therewith (Article 203/4/)", the so-called "obligatory" expenditure, and all other expenditure which is called "non-obligatory".

The obligatory section, making up some 80% of the budget, is mainly agricultural spending which, because of the open-ended nature of the agricultural guarantees, flows automatically from the annual price-fixing by the Council of Agricultural Ministers. Since harvests and world-market developments, or indeed the decisions of the agricultural ministers, are not always easy to predict with any precision the amounts voted on this side of the budget have been seen as estimates rather than as cash limits.

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During the course of the year supplementary budgets have often been required to meet increased agricultural expenditure, thus altering the final balance of the budget. Because the price-fixing is exclusively the responsibility of the Council, (on the basis of Commission proposals), and because of the limitations in the Treaty on Parliament's capacity to alter obligatory expenditure, this area of the budget has been seen as effectively under the control of the Council of Ministers.

The non-obligatory expenditure, on the other hand, clearly provides for Parliament, within the limits of the maximum rate, to have the last word. This covers a wide range of matters, such as regional, social, industrial and energy policy where new policies are being developed but where in comparison to the costs of the CAP spending is relatively small and Community policies are not very far advanced.

The maximum rate of increase of this non-obligatory expenditure is declared by the Commission at the beginning of the budget procedure after technical calculations on GNP volume trends, variations of national budgets throughout Member States, and the trend of the cost of living. The Treaty provides that the maximum rate can be exceeded, but only with the agreement of a weighted majority in both Council and Parliament.

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This distinction between different types of spending and the institutional relationships it implied posed considerable problems for a new directly-elected Parliament determined to exercise effective budgetary powers and to establish a politically acceptable budgetary strategy. Had it accepted the orthodox view of its appropriate role it would have found itself taking decisions of substance only on some 20% of the Budget, and that within limits determined by a maximum rate which it regarded as unduly restrictive, while the other 80% of expenditure was effectively beyond its control and subject to no limitations on its rate of increase. The question for Parliament was how in these circumstances it could create a better balance in the Budget between agricultural and non agricultural spending, particularly if it did not regard simply pushing up non-agricultural spending as an adequate or appropriate, or indeed possible, means of achieving this objective.

The Parliament's response was to challenge the orthodoxy and to show a clear determination to insert itself into the process of determining agricultural spending through the maximum use of its budgetary powers. It took up previously unused devices which enabled it to push the door slightly open, raising the possibility that its proposed alterations in obligatory expenditure could be made effective with the support of a sympathetic minority in Council, and that its powers to reject Budgets and Supplementary Budgets could be used to apply approximate cash limits within which Agricultural Ministers would have to work.

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This radical departure from previous assumptions about the respective institutional roles caused much fluttering in the Council dove-cotes, and it was in the end a combination of institutional pride, unwillingness by Ministers to respond to Parliament's concern about agricultural costs, and the Council's determination to cut proposals in the non-obligatory sector, which led to the rejection by Parliament of the 1980 Budget.

(b) Legislative and Budgetary Powers

The determination of the directly-elected Parliament to assert to the maximum extent its budgetary rights is better understood when we remember that there is in the Community a separation between budgetary and legislative power. The Council has exclusive legislative authority, while the Parliament and Council together form the Budgetary Authority. Thus the Parliament's budgetary powers provide the only point in the Community's decision-making process where it can determine (as opposed to simply influencing) the direction of Community policy.

It is also quite a fundamental question for the institutions whether a decision by the Budgetary Authority to vote funds for a particular purpose has legal effect which allows the Commission, as the institution responsible for implementing the Budget, to spend the money without any other legal base, or whether it is necessary for the Council to pass a Regulation providing for the policy concerned before the Commission can act. If the former were to be the case, then the significance of Parliament's budgetary powers would be greatly enhanced.

It will cause you no great surprise when I say that there are many in the Parliament who take the view that a decision by the Budgetary Authority alone provides sufficient legal authority for action in that field by the Commission, while the Council of Ministers is inclined towards the view that a Regulation is necessary in the vast majority of cases. The Commission finds itself in the position of rejecting both purist views and operating on the basis that the budget does not always provide an adequate legal basis for action, especially when new policies are involved, but that we can without a Regulation carry out an "action ponctuelle" as it is called, best translated as a well-defined and specific action of a limited nature.

The Resolution of Conflict

It is, I think, clear that our budgetary procedures are in a state of evolution and definition which has important implications for the relationships between Community institutions. It is also clear that Parliament and Council quite often disagree. But, you may ask, why should the institutions clash and should there not be procedures for resolving disagreements?

The answer is, first, that the institutional framework of the Community is designed to ensure a certain balance and diffusion of power between the institutions and that some tension between them is therefore inevitable, secondly that the effectiveness of the decision-making process depends on this being a creative tension, rather than an element of disruption, and thirdly, that the institutions have not always made good use of parts of the procedures which are specifically designed to facilitate reconciliation of differences.

The differences between Council and Parliament, although they often involve different interpretations of legal texts, are essentially political and it is appropriate therefore that they should be resolved politically rather than by protracted legal wrangles before the European Court of Justice. That is why we have in the budgetary procedure a system of "conciliation" which provides for Parliament and Council to meet and discuss difficulties at different stages of the process. Before direct elections this device was not always treated with the importance it deserved, largely because the Council was not accustomed to giving great weight to the views of Parliament, but it is now clear that it will be a key factor in ensuring that Council and Parliament succeed in working harmoniously together. It will be essential for the Council to show a willingness to use the procedure as a means of establishing effective partnership with Parliament on the Budget through discussion of priorities, the exercise of political rather than purely technical judgements, and the pursuit of compromise when necessary. If the Parliament finds that the meetings with Council continue to have inadequate preparation, and the exchange of views has no visible effect on Council actions, then "conciliation" could simply become a mechanism for creating frustration among EMPs and add to the areas of conflict between the institutions. Similarly EMPs need to show a willingness to use the opportunities conciliation offers for achieving a compromise with the Council.

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It will help considerably in establishing effective dialogue between Council and Parliament if both institutions can adopt a more disciplined and cohesive approach to the budget. On the Council side this means a greater co-ordination between political statements by Heads of Government and Councils of Ministers, and the actions of Agricultural and Budget Councils, so that budgetary and legislative action follow Community priorities. On the Parliament's side it means ensuring that pressures from specialist committees (transport, regional policy, energy, development etc.) for increased spending in their own areas do not lead to budgetary debates and amendments being used simply for making ineffective political gestures, a discipline which the directly elected Parliament, unlike its predecessor, has made some progress towards applying.

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I have so far referred only in passing to the role of the institution of which I am Member, the European Commission. This is because the Commission, although its work is a central element in the budgetary procedure, is not part of the Budgetary Authority, because the most spectacular political clashes have so far been between Council and Parliament, and because the role of conciliator which the Commission is often required to play can best be appreciated after looking at the scope for conflict. The Commission gives the Budget its initial political steer in presenting the "Preliminary Draft" and providing all the technical information, it is represented at and participates in the discussions of Parliament and Council throughout, and it executes the budget after its adoption.

I would not seek to claim that the Commission has always contributed sufficiently to realism in the budget proposals it has put forward. There has sometimes been a tendency for Commissioners and Directors General, like Parliament's specialist committees and indeed like the "spending" Departments in national governments, to equate success in their area of work with the size of spending plans.

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The approach of "cash limits" in the form of the own resources ceiling has helped to impose greater discipline on our approach, as have the new pressures from the directly elected Parliament. Certainly I hope that the new budget proposal for 1980, which I recently presented to the Budget Authority as a solution to the impasse between Parliament and Council, strikes the right balance between the need for economies and the importance of strengthening Community activities in areas where something practical can be achieved.

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II THE PROBLEM OF MALDISTRIBUTION

The issue which lies at the heart of the institutional difficulties I have described is that of the maldistribution of Community spending, and in particular the overwhelming weight of agricultural spending in the Community Budget. Agriculture is of course the one major internal policy area where a real transfer of competence from the national to the Community level has been made. Through the Common Agricultural Policy it is organised and financed on a Community-wide basis which has no counterpart in other areas of government activity. It is not surprising therefore that it should dominate the budget. Nor should the CAP carry all the blame for the failure of the Community to develop other major common policies.

Surpluses

Nonetheless it is right that the CAP should be a cause of concern. Over the last five years its cost has more than doubled from 12,600 million DM in 1975 to 27,500 million DM in 1979.

It is difficult to justify an annual increase in agricultural expenditure vastly greater than the increase in areas such as regional, social, industrial and energy policy - areas where the Community has been active over the last 5 years in developing new Community measures. The cause of this increase in costs is essentially the increase in quantities of agricultural produce subject to intervention and other support measures i.e. surpluses.

There is no easy or cheap solution to the problem of disposing of these surpluses once they have been produced, and it is on the factors giving rise to surplus production that we need to concentrate. The problem is concentrated particularly in the dairy sector, where surpluses of milk products last year took 45% of all agricultural expenditure, or 32% of the entire Community Budget. These figures illustrate the inescapable connection between mastering the problem of surpluses and curbing agricultural costs.

Matters should not have been allowed to get to this stage. If the Commission's warnings had not been persistently ignored by the Council of Agricultural Ministers, who regularly agree higher price increases in the annual prices settlement than are proposed by the Commission, the present Community crisis on both agriculture and finance might have been avoided. Resolving the problem now will take time; it is rather like the time-lag between turning the wheel of a large tanker at sea and actually succeeding in turning it round. But it can be done and it is essential that we make a start. That is why the Commission has in the last few months made a two-pronged attack on the problem: we have proposed a savings package, a key element in which is a tax on milk producers expanding their production, and a prices package involving lower increases in prices for surplus products than otherwise might be justified. If implemented these proposals provide the opportunity for beginning a shift in the balance of the budget away from agricultural expenditure.

The CAP as an institution

Their fate will now be determined by the Council of Ministers, who should take into account not only the interests of Community farmers, but also the impending exhaustion of the Community's own resources (and therefore the interests of taxpayers), and the need to secure agreement on and adoption of a budget for 1980. The failure in the past adequately to take these wider considerations into account has to a large extent flowed from deficiencies in the institutional arrangements for determining agricultural policy. Now that the impact of agricultural decisions on other areas of Community activity has been highlighted I believe it is time to make radical changes which will end what has hitherto been the "domaine reservé" position of agricultural policy-making throughout the Community institutions. Until now decisions on agricultural prices and related matters have gone through the Council entirely under the auspices of agricultural interests. Those with a broader view of Community policies have not taken sufficient interest in the process.

This is true at the official level where there is a special committee of officials to prepare meetings of the Council of Agricultural Ministers, instead of the normal Committee of Permanent Representatives, generally known as COREPER. It is also true at the highest level where the heads of government meeting in the European Council do not really seem to have succeeded in putting agriculture onto the same basis as other policies.

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I know it is argued that Ministers of Agriculture are not creatures apart from the governments of which they are members, and that their mandates are worked out in the national capitals so as to take account of non-agricultural interests. The fact of the matter is, however, that once the Agricultural Council starts they have time and again shown themselves able to engage in trade-offs between the various agricultural interests that pay little apparent regard to the interests of taxpayers and consumers, or the limits of Community finance.

A fundamental reform required is to bring agricultural spending within the budget framework so that it is subject to financial disciplines and viewed alongside other Community policies. A small step in the right direction was taken by the European Council at Dublin when it was agreed that the Commission's package of proposals for agricultural savings should be referred to the Finance as well as the Agriculture Ministers. This inevitably means an involvement by Finance Ministers in setting the framework for the prices settlement, a long overdue move towards making agricultural policy financially accountable.

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The Commission has a part to play in this as well. When it starts to formulate its proposals for agricultural prices and connected measures it will have to do so within the same context as its other policy proposals. Instead of dealing first with agriculture and then with the rest it should invariably consider both together. The point of departure for the whole budget exercise would therefore be a forecast for the year ahead of income and unavoidable expenditure arising from policies already in operation. The next step would be to decide how much money could be made available in the light of the Community's overall financial position to develop these policies and to initiate new ones. Within this assessment agriculture would be treated on the same basis as everything else. The inter-connection between agricultural and non-agricultural expenditure and the fact that resources allocated to one affect the amount available to the others would thus be clearly established. In this way, of course, a start would be made on putting clear budgetary limits on the fulfilment of all our policy obligations.

Such an approach would be easier to operate if the Budgetary Year and the agricultural year could be made to run more closely together. At present Article 203 of the Treaty lays down that the Budget Year is one calendar year, while the agricultural prices settlement is supposed to take effect from April 1, though it is often delayed for anything up to two months or more.

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I believe the agricultural year and the Budget year should be the same. This would make it both natural and easy for the Commission and the two arms of the Budget Authority to carry through the decision-making process for agricultural and non agricultural expenditure on the same timetable. The possibility of one pre-empting the other as happens at present, would thus be greatly reduced.

III THE EXHAUSTION OF COMMUNITY REVENUE

At the beginning of this talk I referred to the approach of a financial crisis for the Community, and since then I have several times referred back to this point as an important new factor in consideration of the budget. Let me now outline what the Communities revenues are, why they are likely to be exhausted soon, and what the implications of that happening could be.

The revenue of the Community comes from all customs duties, agricultural (customs) levies, and up to 1% of VAT levied on a uniform base. These are paid directly to the Community from Member States who collect them on behalf of the Community, and they are therefore known as Community "own resources".

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Last year finance for Community activities took all of the customs duties and agricultural levies as well as three-quarters of the total potentially available through VAT, or in other words some 90% of the Community's potential own resources. This left a margin for additional expenditure representing only some 5,000 million DM or less than one-fifth of our current expenditure on agriculture.

The Community is likely soon to exhaust this margin for several reasons. First of all, there is the non-buoyancy of our revenues, which do not benefit from the "fiscal drag" on which many national governments rely. It is an objective of international policy that customs duties should be reduced and the income from them has tended to decline in real terms. VAT is more buoyant, but even taking this into account our real overall revenue seems likely over a period of years to remain static. Secondly there is the cost of enlargement. The accession of Greece to Membership of the Community in 1981, possibly followed in a few years by Spain and Portugal, will lead to new demands on the Community Budget even within the framework of existing policies. And thirdly there is the possible budget cost of the resolution of the "British problem" which could lead to significant increases in Community spending in the UK in 1980 and the years following.

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The most important factor of all, however, is agricultural spending. The increase in agricultural costs in 1979 was only slightly less than the total margin left in own resources that year, so it is not hard to see how a cavalier attitude by the Agricultural Ministers to budgetary costs could quickly create a financial crisis. On the fate of the Commission's agricultural savings package and low price increase proposals depends the capacity of the Community to finance its future activities. It is not possible to be precise about the exact date when we will reach the ceiling, given the trade variations which affect our income and our reliance on hypotheses about future expenditure trends. But if agricultural costs were to continue to climb at the same rate as the last 5 years we could run out of money during 1981; if the Commission's agricultural proposals are implemented in full we could probably stave off hitting the ceiling before the end of 1982. The latter would provide a breathing space, and the prospect of curbing agricultural costs over a period of time, but we still need to consider providing for an increase in own resources.

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Why is this a problem? Because the present limits to "own resources", and in particular the 1% VAT limit, were fixed in 1970 by an agreement having the force of a Treaty, which was subsequently ratified by national Parliaments. Breaching these limits has therefore a profound political significance for national governments. A Community proposal to increase the VAT share to (say) 2% would have to be ratified by national Parliaments and governments naturally and very properly view this prospect with some reluctance. There are of course other possibilities, for example the interesting oil tax idea currently under discussion, but these need to be further explored and that could take some time.

A proposal to increase own resources requires the most thorough scrutiny and justification of existing expenditure to ensure that available resources are being put to good use. In particular it is essential that the Community shows itself able and willing to control agricultural expenditure, and to establish a better balance between agricultural and non-agricultural expenditure.

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There are some in national governments who believe this can only be achieved by allowing the Community to run out of money, thereby forcing reforms on the CAP. I believe that to be an abdication of responsibility, which could do great damage to the Community and even result in a Budget in which spending on regional and social policy was squeezed out by continuing expenditure on agricultural guarantees. We must impose reforms which are in any case necessary, though of course given added urgency by the pending exhaustion of own resources, and plan our future financial activities in a rational and disciplined manner. The fact that some of the Member States which are most firmly opposed to raising the ceiling for Community income are also among those which have done most to push up agricultural spending highlights the lack of coherent thinking which seems to be endemic in national capitals on the Community budget.

The European Parliament, in contrast to the normal parliamentary position, has powers over expenditure but no revenue raising powers. This is a gap in the Community budgetary system which Madame Veil quite rightly highlighted in her first speech as President. I believe that now we have a publicly accountable European Parliament we must seriously consider the possiblity of amending Article 201 of the Treaty so as to ensure that in future the power of the Budgetary Authority to spend is clearly matched by its responsibility for increasing the level of own resources.

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CONCLUSION

What should be our conclusions on the Community Budget? It is a modest financial instrument by comparison with national budgets, amounting to only 2.6% of the total of such budgets in the Community last year. But its size alone is not the yardstick by which it should be judged. The important thing is that it should be a central policy instrument for building the European Community, directing resources to where they can most benefit our citizens, and helping to determine our priorities rather than merely reflecting the accounting consequences of decisions taken elsewhere.

If the financial activities of the Community are to achieve our declared objectives it is necessary that they be embraced in a comprehensive Community Budget which provides a central overview of our strategy and our chosen instruments. That means that our increasingly important borrowing and lending activities, and the Community's development aid under the Lomé Convention should be included in the Budget -

which they are not at present. But it also means that the financial impact of Community activities on Member States and regions within Member States should not be perverse.

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In 1978 the Commission published a discussion document on the future financing of the Community Budget in which it argued that a new own resource or indeed an extension of an existing own resource should not be regressive in its impact on Member States, and also suggested that the possibility of establishing the principle of progressivity should be studied. The European Parliament has since then made a constructive contribution in this area where it supported the proposal put forward by the German Chairman of the Budget Committee, Herr Lange, that the Community should seek to further economic convergence between its Member States not only by co-ordination of economic policy, but also by adopting a system of financial equalisation based on per capita GDP derived from experience within the Federal Republic

This is not the time for me to discuss these ideas in detail, but I do believe that a failure to accept at Community level the principle we all accept at national level, namely that those who have most should contribute most, can not be held to be in the interests of a cohesive and developing Community. This is not just a question of the current problem of one Member State: it is a fundamental question of principle for future Community budgets.

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The role of the Community Budget is complementary to that of national budgets, but it can still be significant. Strict public expenditure control must, of course, be observed at the Community as at the national level and there should be no unnecessary duplication by national governments of activities transferred to the Community. I believe that Community spending on areas such as industrial and energy policy will and should increase significantly, but if Community taxpayers are to get value for money this must be matched by economies on agriculture. The problems of achieving the right balance are considerable but given goodwill in the Council of Ministers, consistency in the European Parliament and a firm and principled stand by the European Commission in defence of the European interest we can overcome them and make of the Community Budget something which all our citizens recognise as influencing for the better the Europe in which they live.