

Financing the European Union: Options for Reform



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This article reviews the budget of the Union, its size, sources of revenue, areas of expenditure and considers, first, how it may be reformed so that it can serve better the objectives of the Union and, second, how Member States can share more fairly the burden of financing it. The article argues that agricultural spending should be reduced, structural funds should be more concentrated and that any mechanism to correct budgetary imbalances should also take into account excessive surpluses as well as excessive deficits.

1. Introduction

In mid-June, just two weeks after the Constitutional Treaty was rejected by two founding Member States, EU leaders failed to reach agreement on the financing of the Union – the so-called Financial Perspective – for 2007-2013. This failure deepened the sense of crisis in the EU.¹ Money matters in the EU.

In this article we review the budget of the Union, its size, sources of revenue, areas of expenditure and consider, first, how it may be reformed so that it can serve better the objectives of the Union and, second, how Member States can share more fairly the burden of financing it.

Albeit small – just 1% of EU GNP – the budget is given particular importance by the Member States. Therefore, we examine the merits of the view that some Member States get a "raw deal" from EU expenditure.

Some of the options for budgetary reform we explore here are unlikely to be adopted. In fact, the Commissioner responsible for the budget, Dalia Grybauskaitė, is reported to believe that extensive reform cannot be achieved any more because there is simply not enough time before the current Financial Perspective expires.² Our task is not to try to predict the outcome of the on going budgetary negotiations. Instead we offer some tentative answers to two supposedly simple questions, namely what and how? What policies should the EU finance and how should it finance them.

The following section puts things in perspective. It reviews the budget in terms of its aims, evolution and structure of revenue and expenditure. This is followed by an analysis of net budgetary balances showing the financial burden-sharing among the Member States. The fourth section considers which policies the EU should fund. Section five evaluates the Commission proposal for the Financial

Perspective 2007-2013. In the last section, we outline our own ideas on how the EU budget can be reformed so that expenditure becomes more efficient and equitable.

Please note that due to space restrictions, the paper version of *Eipascope* does not contain all the relevant budgetary statistics. They are annexed to the internet version of *Eipascope* which can be accessed at www.eipa.nl.

2. Evolution and structure of the EU Budget

Apart from the fact that the EU budget is determined by EU institutions, it differs from national budgets in two fundamental respects.³ First, it is very small – around 1% of EU GNP – compared to total public expenditure in all Member States of around 50% of EU GNP. It is also legally prevented from exceeding 1.27% of the EU GNP. Second, the EU budget is legally required to be in balance each year. Unlike its members, the EU cannot run deficits. The budget, therefore, cannot be used to affect in any significant way overall economic activity in the EU – a normal task of national budgets.

The budget has grown from an amount equivalent to €7.3 billion in 1958, which was denominated in Belgian francs and was used exclusively for administrative expenses, to €100.1 billion in 2004.⁴

Typically, the budget during its first 30 years followed the development of the common agricultural policy. Starting in 1988, structural funds and internal policies such as R&D and, from 1993, external aid have gained importance.

While its absolute size has grown and will continue to do so, in relative terms, a peak was reached in 1993 with spending at 1.18% of EU GNP. Contrary to public opinion, relative expenditure has in fact decreased since then. It now stands at 0.98% of EU GNP.⁵

2.1. The revenue side

The EU budget is financed by the so-called "Own Resources". There are four income sources that cannot exceed 1.24% of EU GNI⁶ (or 1.27% of GNP), which is the ceiling agreed by the European Council in Berlin in March 1999.

The first two sources of revenue – agricultural levies and customs duties are known as the "Traditional Own Resources" (TOR) of the EU. The TOR reflect the financial autonomy of the EU because they are regarded as resources that belong to the EU and are levied directly on economic agents. The VAT and GNI-based resources are financial contributions from the Member States' national treasuries to the EU. However, all payments into the EU budget are classified as "Own Resources of the EU".

2.2. The expenditure side

As shown in Table 2, the budget is divided in six main areas.

The common agricultural policy (CAP) and the structural funds are the main spending priorities. Together they make up around 75% of the total budget, with the CAP being the largest at more than 45%. Their share in appropriations for commitments is even larger, reaching 80% of the total budget.

3. Budgetary imbalances

When the EU budget attracts public attention it is mostly for negative reasons: mismanagement and outright fraud. More recently, however, the issue of *juste retour* has entered public discourse. Politicians have been asking who pays for the EU and who benefits from EU spending? These are deceptively simple questions which, as explained below, cannot be given simple answers.

In the EU15, more than 50% of total CAP expenditure is absorbed by only three countries: France (24%), Spain (15%) and Germany (13%). Spending from structural funds is equally concentrated (as it should be): Spain, Italy and Germany take more than 50%. Spain alone accounts for a staggering 32%. As we explain later on, structural funds should be focused. But we will also question whether it makes sense to allocate such high shares to countries with incomes above the EU average.

With respect to the revenue, more than half comes from contributions from three countries alone: Germany (23%), France (18%) and Italy (14%).

The receipts of the Member States do not normally match their contributions to the budget. This creates deficits and surpluses or "imbalances". Germany is the largest contributor and Spain is the largest recipient in absolute terms. Indeed for many years, countries like Germany, The Netherlands and the UK have been net payers and countries like Spain, Greece, Portugal and Ireland have been net recipient.

The picture is slightly different when imbalances are expressed in per capita terms. Per capita positions are better indicators of the real effects of budgetary flows since they relate to the burden borne or gain obtained by each person. In per capita terms the Benelux is the highest net contributor, with Germany only in fifth place (This ranking excludes administrative expenditure by EU institutions. If it is included in the receipts of Member States, then the receipts of Luxembourg and Belgium increase considerably and Luxembourg becomes the largest net beneficiary per

Table 1: Sources of revenue, 2005

Type of revenue	million €	%
1. Agricultural duties and sugar levies	1,613.0	1.5
2. Customs duties	10,749.9	10.1
3. VAT	15,313.5	14.4
4. GNI-based	77,583.1	73.0
Total (including surplus)	106,300.0	100.0

Source: European Commission⁷

Table 2: Expenditure, 2005
(appropriations for payments)

Policy area	million €	%
Agriculture	49,115	46.23
Structural funds	32,396	30.49
Internal policies	7,924	7.46
External policies	5,476	5.15
Administration	6,293	5.92
Pre-accession aid	3,287	3.09
Total (with reserves)	106,241	100.00

Source: European Commission⁸

capita). Ireland, Portugal, Greece and Spain are the highest net recipients respectively. Ireland is an aberration here because it has grown to become the second most prosperous Member State in the EU25. We return later on to the Irish case because it reveals more starkly the problem of funding poor regions in rich countries.

3.1. The UK rebate

The UK has always had a considerable negative budgetary balance. This has been largely caused by two factors. First, on the spending side, the predominance of the CAP coupled with the relatively small size of the agricultural sector in the UK economy has meant that the UK obtains a relatively smaller proportion of EU expenditure. Second, on the revenue side, the UK's extensive trade links with the Commonwealth and North America have resulted in a larger amount of tariff revenue contributed to the EU budget.

In 1984, the then British Prime Minister, Margaret Thatcher, succeeded in getting her "money back" by securing an "abatment" or "rebate". On the basis of a complicated formula, each year the EU returns to the UK a certain amount of money. This corresponds to €4.5 billion this year or 66% of what its net balance would otherwise be. All remaining 24 Member States contribute to this rebate – even the poorest of them. What is less well known is that since 2000, Austria, Germany, The Netherlands and

Table 3: Relative prosperity of Member States, 2004

Per capita income as % of EU average			
LU	245.7	CY	89.6
IE	133.1	EL	88.3
AT	127.6	SI	83.2
DK	126.6	PT	77.2
UK	126.2	MT	75.1
BE	125.8	CZ	73.8
NL	125.3	HU	62.7
SE	119.5	SK	57.7
FI	118.6	EE	52.9
FR	117.7	PL	50.7
DE	112.2	LT	50.6
IT	111.8	LV	47.6
ES	100.6	EU25	100.0

Source: Eurostat

Sweden, because they too protested that they paid too much into the budget, contribute only a quarter of what they would otherwise bear for the UK abatement.

In section 6 we consider whether the UK, which is now one of the richest countries in the EU, should be subsidised by other Member States, some of which have per capita income as low as 40% of that of the UK (see Table 3).

3.2. Do net balances represent the net costs and benefits of EU membership?

The answer is no.⁹ The derivation of net balances depends on what is included on the revenue and expenditure sides of the budget. The Commission, for example, does not include tariff revenue because it regards it as belonging to the EU. Indeed, had the EU not existed, some countries, notably The Netherlands, would not collect tariff revenue on goods offloaded in Rotterdam and destined, for example, for Germany or Denmark. These goods would have been in transit and tariffs would have been levied by the country of the final destination.

More fundamentally and aside from the problem of how to measure budgetary balances, these balances fail to capture to any significant degree the economic, let alone the political, benefits or costs of EU membership. Net balances cannot measure the effects of EU policies, increased trade, investment and regulatory harmonisation. It is also difficult to identify the

ultimate beneficiaries of EU expenditure (e.g. research funds obtained by multinational consortia). It is said that 40% of capital investment supported by structural funds in cohesion countries eventually flows back to the main capital manufacturing countries which happen to be the net contributing Member States.

4. What should the EU support through its budget?

Public finance attributes three "classical" functions to public spending and budgets: allocation, (re)distribution and stabilisation.¹⁰ We examine whether similar functions can be performed by the EU budget.

The allocation function of public finance involves the supply of public goods. A public good is different from a private good in that it cannot be provided through the free market because consumption by non-payers cannot be prevented. Due to this market failure, a political process is necessary for the supply of public goods (e.g. policing, defence, education, parks, clean air). In the context of the EU, collaborative R&D and environmental protection are examples of trans-national public goods that should be funded through the EU budget.¹¹ In addition, there are goods which are not strictly public but which cannot be achieved by any individual country such as strong bargaining in the WTO or with the US. We call these cooperative goods. Lastly, in this allocative function we would also include funding for EU institutions that ensure the EU system operates properly and EU rules are applied effectively.

The (re)distributive function of the public budget aims to create equity in the structure of national income and wealth. The extent of redistribution is a political choice. The EU budget plays a significant role in redistributing income among its Member States through structural and cohesion policies. As long as the EU Treaty retains such policy objectives, we regard their funding through the EU budget as unavoidable. But, even if these policy objectives were not in the Treaty, some redistribution would still make sense for the following reason. The prosperous countries are more likely to gain from EU membership through trade and investment. Therefore, it is in the interest of those countries to ensure that poorer Member States also support integration because they can also gain from cohesion policies which in this context can be seen as the necessary "side payments"

to facilitate integration. The recently established solidarity fund can also be included here.

The stabilisation function of public finance smoothes out the inter-temporal, inter-sectoral and inter-regional impact of asymmetric shocks in the economy. It involves the use of fiscal policy – spending and taxes – as a means of maintaining

high employment and a high rate of economic growth. But, as long as the EU budget remains small – its current ceiling is 1.24% of EU GNI – it will have virtually no stabilising power.

It follows that on the basis of public finance theory, in addition to outlays of Community institutions, the EU

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budget should primarily finance trans-national public goods, cooperative goods and cohesion/solidarity instruments. As we have put it elsewhere, "the Union should support those policies or finance those actions that make it more cohesive, more competitive and give it a more effective voice in the world."¹² In their wide-ranging report on the future of the EU, Sapir et al. reach similar conclusions.¹³ They support reform of the budget so that it funds economic growth (primarily research), convergence (primarily structural actions) and restructuring (primarily for industrial adjustment).

It is obvious that we have left out the CAP which accounts for almost 45% of EU spending. This is because agriculture is a declining sector representing no more than 3% of the EU economy and no more than 5% of EU labour force, even after enlargement. The CAP is an interventionist policy that distorts both domestic production and trade, although to a lesser degree now after a decade of reform. The important point to note here is that as the EU shifts away from production subsidies, trade restrictions and export subsidies and towards direct income support, there is less and less justification for funding through the EU budget. While production subsidies and trade restrictions require centralised management of prices and trade flows and thus EU intervention, direct income support can be delivered by each Member State without affecting farmers in other countries. There is no need for EU intervention.

Sapir et al. have called the EU budget an historical relic. They argue that "expenditures, revenues and procedures are all inconsistent with the present and future state of EU integration." We agree with them.

5. An appraisal of the Commission proposal for the next financial perspective

The Commission proposal for the FP 2007-2013 aspires to create a budgetary basis that can accommodate the present and future challenges facing the EU primarily due to enlargement and the Lisbon strategy. It also tries to take on board some of the recommendations in the Sapir report.

The FP 2007-2013, totalling €1000 billion, is arranged in the following categories of expenditure [in brackets are the amounts per heading for the seven-year period]¹⁴:

- Heading 1: **Sustainable growth** [€ 471 billion] is subdivided into:
 - Competitiveness for growth and employment*, this includes expenditure on R&D and innovation, education and training, trans-European networks, the internal market and associated policies [€133 billion].
 - Cohesion for growth and employment*, to promote convergence of the less developed Member States and regions, and to support territorial cooperation [€339 billion].
- Heading 2: **Preservation and management of natural resources**, which encompass the common agricultural and fisheries policies, rural development and environmental measures [€405 billion of which €301 billion for agriculture].
- Heading 3: **Citizenship, freedom, security and justice**, is a heading for several new policies, mainly justice and home affairs, border protection, immigration and asylum policy, public health and consumer protection, culture, youth, information and dialogue with citizens. It also covers the EU's solidarity and rapid reaction fund [€25 billion].
- Heading 4: **The European Union as a global partner**,

Table 4: Estimated net budgetary balances (average 2008-2013) as % of GNI

Estimated net budgetary balances as % of GNI	Current UK correction	GCM with 0.35% threshold & cap at €7.5 billion
BE	1.21%	1.26%
CZ	3.17%	3.20%
DK	-0.31%	-0.26%
DE	-0.54%	-0.48%
EE	3.76%	3.79%
EL	2.16%	2.19%
ES	0.23%	0.26%
FR	-0.37%	-0.33%
IE	0.47%	0.51%
IT	-0.41%	-0.35%
CY	-0.37%	-0.33%
LV	4.40%	4.45%
LT	4.41%	4.44%
LU	5.80%	5.83%
HU	3.06%	3.09%
MT	1.06%	1.10%
NL	-0.56%	-0.48%
AT	-0.38%	-0.41%
PL	3.76%	3.79%
PT	1.50%	1.54%
SI	1.31%	1.34%
SK	3.27%	3.30%
FI	-0.25%	-0.20%
SE	-0.50%	-0.45%
UK	-0.25%	-0.51%

Source: European Commission¹⁵

this covers external action, including pre-accession aid, the European Development Fund (EDF) which will be integrated into the budget, and emergency aid and loan guarantees [€95 billion].

- Heading 5: **Administration**, this covers institutional costs like salaries, pensions etc. [€29 billion].

Despite the rhetoric on the need to reduce expenditure on agriculture, the EU still intends to allocate more than 40%

of its budget to farming and rural development. The scheduled accession of agriculturally more intensive countries such as Romania, where 40% of labour is employed in agriculture, will make future reform of the CAP an even more intractable problem. Perhaps the Commission decided that it is politically expedient to retain agricultural spending largely at current levels after it has seen that Eurosceptic farmers in central and eastern Europe have become markedly more pro-EU after they started receiving money from Brussels.

In terms of the overall size of the budget, the Commission proposed that the current ceiling of 1.24% of EU GNI is retained. This is contrary to the demands by the five largest net contributing countries, led by The Netherlands, that want expenditure capped at 1% of EU GNI.

The Commission also retains the current ceiling of 4% GNI of the recipient countries for structural support. This means that the poorest Member States will get less money per capita than more prosperous states of similar population size. This ceiling has been defended on the grounds that higher allocations of Community money cannot be easily absorbed by the recipients as they have to be matched with national money. However, we do not see any serious reason why the ratio of national contributions cannot be lowered so that the per capita receipts of beneficiary countries can be increased. Alternatively, the required national co-financing ratio can be proportional to the per capita income of the recipient country so that the richer countries contribute more.

The old Member States will still absorb about 50% of all

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structural funds. In fact, some of the old Member States will continue receiving structural funds by virtue of the fact that they receive them in the current FP. This is despite the fact that they have reached very high levels of prosperity, most strikingly in the case of Ireland. This is contrary to the objective of concentrating Community aid where it is most needed. By contrast, Cyprus with 30% less per capita income than Ireland will be receiving much less money simply because today it is not eligible for assistance as "Objective 1" region.

On the revenue side –

and in response to the widespread critique of the UK rebate – the Commission proposes a generalised correction mechanism of budgetary imbalances. This mechanism seeks to compensate each Member State that experiences negative net balances above a certain threshold.

Even after the introduction of this corrective mechanism, the old Member States are mostly net contributors and all new Member States with the exception of Cyprus are net recipients. This is broadly in line with the cohesion goal of the EU. However, the corrective mechanism does not eliminate some awkward disparities between Member States. As can be seen in Table 4, Cyprus will have a deficit that is expected to reach 0.37% of its GNI. The Commission formula will reduce the Cypriot deficit to about 0.33% of its GNI. By contrast, Denmark which is almost 50% richer than Cyprus on a per capita basis will have a deficit of 0.26% of GNI.

These anomalies are the result of the choice of policies on which the EU spends money. Curbing excessive budgetary burden is important, but a move towards a system where everyone gets back the same as they put in (recycling funds

Table 5: Example of modulation of national contributions according to relative capacity to pay

	Country A	Country B	Country C	Union
Population (% of total)	50 million (70%)	20 million (28%)	1 million (1.4%)	71 million
GNI (% of total)	1250 billion (79%)	300 billion (19%)	35 billion (2.3%)	1585 billion
GNI/capita	25,000	15,000	35,000	22,324
Budget: 1.2% of Union GNI				19 billion = 268/person
Equal contributions at 268/person	13.4 billion 71%	5.4 billion 28%	0.27 billion 1.4%	
Contributions according to share in Union GNI	15.01 billion 79%	3.61 billion 19%	0.44 billion 2.3%	

via Brussels) is pointless. Financial redistribution through the EU budget only makes economic sense if it aims to foster economic and social cohesion and efficient allocation of public goods.

6. How should the budgetary burden and receipts be shared in an enlarged EU?

In section 4 we saw that public finance theory attributes certain roles to public budgets, only two of which appear to fit the EU. These are the allocative and redistributive roles. In this section we examine how Member States should share the budgetary burden or how their contributions should be determined and how EU spending should be divided among them. Our own thinking and therefore our proposals are based on the premise that contributions and cohesion-based receipts should be determined according to the national capacity to pay and national need, respectively, both of which are indicated by per capita income.¹⁶

6.1. The revenue side of the budget or national contributions

Not much can be changed on the revenue side of the budget because national contributions are broadly equitable. This is due to the large and rising share (70%) of the GNI-based payments. However, the remaining 30% should also be taken into account so that the overall amount should be directly linked to each country's prosperity.

At present the Commission excludes tariff revenue from the calculations of national deficits (or surpluses) because it regards it as belonging to the EU. This is broadly right for Belgium and The Netherlands which have two of the largest ports in Europe and which would not have collected as much tariff revenue in the absence of the EU. However, for other Member States and especially the new ones, tariffs are a significant source of public revenue which is now being turned over to the EU solely because they have become EU members.

The whole of the contributions of Member States should be determined according to relative capacity to pay. An example of a union with three hypothetical Member States is shown in Table 5 to clarify how contributions vary when they are shared equally and when they are shared according to the size of the economy which is equivalent to the relative wealth of each country or its capacity to pay.

6.2. The expenditure side of the budget or national receipts

Determining a formula for contributions is rather easy. The real problem is on the expenditure side precisely because national deficits or surpluses are caused by the Community spending pattern which in turn has very different impact on the various Member States.

A budget based on the principle of national need (which

corresponds to the principle of capacity to pay on the expenditure side) would be reformed as follows.

First, cohesion receipts should be proportional to national income. At present, all Member States draw on Community structural funds because eligibility (for Objectives 1 and 2) is determined according to regional income. All Member States have regions that are relatively poor – even Luxembourg with per capita income over 200% of EU average.

However, a poor region in a rich country is not in a similar situation as a poor region in a poor country. There is much more capacity for regional redistribution within rich countries rather than poor countries. Therefore, it does make sense to restrict eligibility for regional aid to regions situated in Member States with per capita income less than the EU average or some other cut-off point. Politically, this will not be easy to achieve because some countries such as Spain, whose relative income has reached virtually 100% of the EU average, is the largest recipient of EU structural funds. But, there is not much logic to the current proposal for the 2007-2013 period, that still envisages 50% of structural funds going to the old Member States which, with

the exception of Greece and Portugal, have per capita incomes above the EU average.

Second, a large part of the CAP should be re-nationalized. In fact, all agricultural spending that goes to direct income support need not be recycled through Brussels. That would reduce by 60-70% current CAP spending. Member States should be free to determine how much they want

to boost the income of their farmers. There is no need for collective EU decisions on this issue. Nor will national income supplements create any negative externalities that can harm other countries (provided, of course, that such supplements are truly de-coupled from production). In fact, the present system of direct income support perpetuates a gross inequality as the amount that is paid to farmers is linked to the amount of production subsidies they used to receive under the old regime of market support. It is a mistake to believe that EU funding brings about equality of support of farmers across Europe.

6.3. And the correction mechanism for excessive net contributions?

The rebate for the UK has been justified on the grounds that its economy is different from that of the "typical" Member State. But on reflection, the reasons cited in section 3.1 why the rebate was introduced are feeble. Why should it matter that a Member State imports too much from third countries or that it has a relatively small farming sector? The EC Treaty, for example, does not attribute any particular importance to the source of imports or the size of the farming sector. The net financial position of each country is the natural outcome of the collective policy choices. It is unavoidable that some countries gain more than others.

A generalised correction mechanism can be justified in

The net financial position of each country is the natural outcome of the collective policy choices. It is unavoidable that some countries gain more than others.

Table 6: Modulation of net balances with a generalised correction mechanism

	Country A	Country B	Country C
Contributions (according to share of GNI)	15.01 billion	3.61 billion	0.44 billion
Assumed receipts without correction (% of budget)	10 billion (53%)	8 billion (42%)	1 billion (5%)
Net balance (% of own GNI)	-5.01 billion (-0.4%)	+4.39 billion (+1.5%)	+0.56 billion (+1.6%)
Correction thresholds as % of own GNI: deficit = 0.35; surplus = 1.0	-4.38 billion	+3.0 billion	+0.35 billion
Correction needed	+0.63 billion	-1.39 billion	-0.21 billion
Method of correction Option I: Increase receipts keeping budget at 19 bn			
Corrected receipts	11.6 billion	6.61 billion	0.79 billion
Corrected deficit/surplus	-3.41 (0.273%)	+3.00 (1%)	+0.35 (1%)
Option II: Receipts at max ceilings (budget falls to 17.4 bn)			
Corrected receipts	10 billion	6.61 billion	0.79 billion
Corrected contributions	13.35 billion	3.61 billion	0.44 billion
Corrected deficit/surplus	-3.35 (0.268%)	+3.0 (1%)	+0.35 (1%)

the present context because EU spending is not efficient. It supports policies, such as the CAP, for which it cannot be credibly argued that EU funding is necessary to support the production of some European public good. But, once this kind of inefficiency is removed from the budget, a correction mechanism is no longer needed.

There is also another problem with any automatic correction mechanism. If it is unfair for any country to experience excessive deficit (however that may be defined), why is it not unfair for any country to experience excessive surplus? No one has so far considered whether there should also be a corresponding ceiling on net surpluses. At present there is only a ceiling with respect to structural funds and that is because of the difficulty of Member States to provide matching funds. The essence of fairness is its symmetric nature. If the EU wants to intervene to adjust the results of its own policy decisions, as far as deficits are concerned, then it should intervene to correct surpluses. But such intervention generates some surprising results.

Table 6 depicts the effects of a generalised correction mechanism for our three-country union. Our calculations are based on a double ceiling which is 0.35% of GNI for deficits and 1% of GNI for surpluses. The results demonstrate that such ceilings necessarily imply either an increase in the receipts of the net contributing country (shown as option I in the Table) or a limit on the overall amount of the union budget together with a decrease in the contributions of that

As long as CAP spending is maintained at present levels, there is little hope that the budget will actually serve as a stimulant for growth and cohesion.

country (shown as option II in the Table).

The usefulness of these calculations is that they demonstrate the consequences of any far-reaching reform of budgetary arrangements in the EU. The introduction of any generalised correction mechanism cannot work if EU expenditure is automatic or pre-fixed across all members. But this is precisely how CAP spending is currently determined. All far-

members are automatically entitled to support from the EU budget. Member States only determine the overall budget and the level of support for each agricultural product, unit of land or head of animal. Once these amounts are set, then any farmer in any Member State is eligible to receive funding. It is clear that such automaticity is contrary to the logic of budgetary adjustments according to the paying capacity or need of Member States. It follows, therefore, that the CAP rules, not just the politics associated with it, are the biggest obstacle to budgetary reform.

7. Conclusions

In this article we examine the budget of the EU and consider how it can be reformed so that the Union can add more value at the European level as it enlarges further.

Our main criticism of the current budgetary arrangements and the FP 2007-2013 is that they are too entrenched in "old" policies – principally agriculture – and that structural funds are made available to any poor region regardless of the level of income of the country in which they are situated.

The UK abatement has lost its justification. Although, the current proposal of a generalised correction mechanism is not a panacea, the idea of a "juste retour" does not make economic sense and should be avoided.

Our main suggestions for reform are that, first, the EU budget should finance policies that strengthen cohesion, stimulate competitiveness and give the EU a more effective voice in the world. Second, the principle for determining contributions should be the same as that for receipts and it should be the paying capacity and needs, respectively, of each Member State. This is a robust and sustainable

foundation for the future budget of the EU. However, it should be pointed out that it also limits the revenue received by Member States.

As long as CAP spending is maintained at present levels, there is little hope that the budget will actually serve as a stimulant for growth and cohesion. The financing of the EU will continue to require ad-hoc adjustments that will make future consensus on budgetary issues more difficult to achieve. In fact, given the little time left for any extensive reform, the next FP will not be very different from the present one. ::

NOTES

- * We are grateful to Eipascope's editors for very useful comments on an earlier draft. We are solely responsible for the views expressed in this article.
- ¹ For an analysis of the reasons for that failure see John Peet, *The EU Budget: A Way Forward*, Centre for European Reform, London, July 2005. For an account of the politics in the run up to the June European Council see Phedon Nicolaides, "National Red Lines Undermine European Budgetary Reform", Eipascope, 2005, no. 1.
 - ² See her interview on the Euractiv site at: "<http://www.euractiv.com/Article?tcaturi=tcm:29-142912-16&type=Interview>"
 - ³ For more detailed explanations of the EU budget see I. Begg & N. Grimwade, *Paying for Europe*, (Sheffield Academic Press, 1998); T. Wynn, *The EU Budget: Public Perception and Fact*, Committee on Budgets of the European Parliament, 2005.
 - ⁴ European Commission, *European Union Financial Report 2004*, Luxembourg, 2004.
 - ⁵ T. Wynn, *The EU Budget: Public Perception and Fact*, Committee on Budgets of the European Parliament, 2005, p. 7.
 - ⁶ The measure of Gross National Income is larger than that of the Gross National Product because the former contains all income from all sources worldwide that can be attributed to national beneficiaries.
 - ⁷ European Commission, *Preliminary draft general budget of the European Commission for the financial year 2006, General Overview*, Brussels, Luxembourg, May 2005.
 - ⁸ *ibid*
 - ⁹ See European Commission, *Allocation of EU operating Expenditure by Member State*, September 2004.
 - ¹⁰ For a more detailed explanation see R. Musgrave & P. Musgrave, *Public Finance in Theory and Practice*, (New York: McGraw-Hill, 3rd edition, 1980).
 - ¹¹ This is what the theory of economic federalism suggests. See W. Oates, "An Essay on Fiscal Federalism", *Journal of Economic Literature*, vol. 37, 1999.
 - ¹² See Nicolaides, 2005, *op. cit.*
 - ¹³ A. Sapir et al., *An Agenda for a Growing Europe, The Sapir Report*, (Oxford: Oxford University Press, 2004).
 - ¹⁴ European Commission, *Financial perspectives 2007-2013, Added value and delivery instruments*, Communication from the Commission to the Council and the European Parliament, COM(2004) 487 final
 - ¹⁵ European Commission, *Proposal for a Council decision on the system of the European Communities' own resources*, COM(2004) 501 final/2, 3 August 2004.
 - ¹⁶ There are many recent reports on how the EU budget should be reformed. See, for example, I. Begg, *Funding the European Union*, The Federal Trust, 2005; M. Buti & M. Nava, *Towards a European Budgetary System*, Robert Schuman Centre for Advanced Studies, European University Institute Working Paper 2003/08, 2003; D. Gros & S. Micossi, *A Better Budget for the European Union: More Value for Money, More Money for Value*, Centre for European Policy Studies, Policy Brief 66, February 2005; J. Le Cacheux, *European Budget: The Poisonous Budget Rebate Debate*, Notre Europe, Studies and Research 41, 2005; S. Richter, *Scenarios for the Financial Redistribution across Member States in the European Union in 2007-2013*, Research Report 317, Wiener Institut fuer Internationale Wirtschaftsvergleiche, April 2005.

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