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No. 66/February 2005

Thinking ahead for Europe

A Better Budget for the European Union

More Value for Money
More Money for Value

Daniel Gros and Stefano Micossi

Abstract

The EU budget needs to be radically reformed if it is to reflect the priorities of an expanding and deepening Union. Over 40% of EU spending is dedicated to support for agriculture, a declining sector; spending for research and innovation, the main driver of productivity growth, is too small; and there is no room in the budget for the new public goods of internal and external security that public opinion demands. Reform is impossible, however, as long as the budget is determined by an inter-governmental negotiation in which no party defends the over-arching European interest. Each member country only cares about its own 'net balance'. Radical changes are needed both in the content of the budget – its revenues and spending programmes – and in the decision-making procedures to endow the Union with an effective instrument to foster its policy goals. The latter is a precondition for the former. Only with a new procedure, one in which European interests dominate, can the Union obtain a better budget. The European Parliament, which represents European citizens directly, must be given the main say concerning the structure of the budget, whereas the Council should provide appropriate safeguards against excessive spending. Movement in this direction can start immediately, even within the present legal framework, if Parliament uses its veto power to ensure a better allocation of expenditure.

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A Better Budget for the European Union

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1. Introduction: The need for a fundamental rethink of the EU budget

Most independent observers agree that the budget of the European Union no longer reflects its main tasks and policy goals. Support for agriculture, a declining sector with little prospects of employment and growth, still represents over 40% of total expenditures; funds for education, research and infrastructures barely surpass one-third of the total; the allocation of money to the paramount goals of foreign policy, defence, internal security, immigration and citizen rights is negligible, despite strong demand by the public for greater Union involvement in these areas.

The current composition of spending is the result of historical accidents. The key driver behind the two items that now dominate the budget – agriculture and regional aid – was the perception in a grey past that Europe needed to ensure its own food supply and, in the 1980s and 1990s, that poorer member countries needed to be bribed to accept the internal market and monetary union. The main legacy of the 'founding' compromises on agriculture and structural funds is that the budget is basically seen as a vehicle for the redistribution of money between member states, rather than a tool for fostering common goals.

National interests are thus framed exclusively in terms of what national treasuries have to pay to, and what farmers and regions at home are likely to receive from the EU budget. But this means that in the intergovernmental negotiations that determine the budget no voice will defend overall EU interests. For any individual member country the return from defending an EU-wide, encompassing interest is negligible compared to the advantage it can obtain from a change in the budget that might lead to lower overall efficiency, but to more money for its own citizens or regional governments.

Thus, negotiations on the budget mainly are of an intergovernmental nature, and tend to concentrate on the net balances resulting from national contributions to the budget and funds received by each country under the various spending programmes.

European citizens have no clear perception of the total cost of the Union and the overall benefits of common action financed by the budget, but they are well aware of budgetary transfers in their favour and place pressure on their government to preserve them indefinitely.

The increasing detachment of the budget from the Union's own objectives is sustained by decision-making procedures that entail strong rigidity in budgetary allocations.

The decisions on the resource ceiling and the allocation of spending among the main budget headings are taken with the multi-year financial perspectives (MYFP), by established practice for seven years; they belong to the Council and require unanimity. Moreover, more often than not, decisions on agriculture and other multi-year programmes (e.g. research) are taken outside the budgetary procedures and with reference to a different time frame.

The European Parliament only has formal decision powers in the yearly budget, after the ceilings for spending for the main headings have been set by the multi-year financial perspectives; at this stage, reshuffling resources around is close to impossible. Therefore, it comes as no surprise that budgetary allocations are only a pale reflection of the evolving policy goals of the Union.

The negotiations for the new MYFP 2007-13, already under way, are not tackling the issue. They have already been prejudged by the Franco-German compromise, in 2002, to block further reform of agricultural policies until 2013. On this premise, the Commission proposal to increase budgetary appropriations up to 1.24% of the EU combined GNI would simply increase to unsustainable levels the national contributions of net payers with scant value added to common policies.

On the other hand, the stated intention by a growing number of member states to limit appropriation commitments to 1% of GDP squarely shifts most of the adjustment burden onto structural funds, a sure harbinger of bitter rows and negotiating standoffs between old recipients and new entrants. There will be little room for the shift of resources in favour of research, education and institution-building, badly needed to revamp growth, and the new requirements for foreign policy, defence and internal security.

We should seize the occasion of these ongoing negotiations to open discussion on a fundamental rethink of the EU budget. This is the last chance to do so without being under duress. By 2013, the impending accession of Turkey will in any event deal the final deathblow to the present budget structure.

Radical changes are needed both in the content of the budget – its revenues and spending programmes – and decision-making procedures to endow the Union with an effective instrument to foster its policy goals. The latter is a precondition for the former. Only with a new procedure, one in which European interests dominate, will the Union obtain a better budget.

Citizens must be made fully aware of the costs and benefits of the European budget, to be able to decide deliberately on the money they are willing to spare for the Union. The European Parliament, which is the citizens' direct representative in European institutions, must be given the main say in budgetary decisions, with appropriate safeguards against excessive spending. The debate on these changes should be opened immediately.

It is not possible to change the formal decision-making procedure before the Constitutional Treaty has entered into force, but the nature of the budgetary process could be changed radically if a political agreement can be reached on what is needed.

The European Parliament can make a major contribution by refusing to recognise the calamitous deal on preserving agricultural spending at current levels until 2013.[1] The Council should know that a low ceiling on own resources, is incompatible with continuing spending on agriculture.

This contribution starts by analysing what Union policies should be and, as a consequence, what changes would be required in the way resources for the Union are raised. It then turns to how decision-making procedures should be changed to make the budget an expression of European, rather than national interests, and an effective instrument in support of Union policies. In the conclusion, we sketch a budget that 'makes sense' for the Union of the 2010s.

2. What tasks for the EU budget?

What tasks should the European Union usefully perform, and does the Union require a much bigger budget to do them? Historically the first aim of the European Union has been to open markets and integrate national economies. Market integration has been largely achieved for manufactured products, but not yet in the main for services, where a lot needs to be done; this function is mainly of a regulatory nature, however, and does not require substantial spending at the EU level. Greater resources are mainly needed to strengthen market surveillance and enforcement at national level.

The final step in economic integration – the adoption of a common currency – has also already been taken. However, the approach that underlies the Maastricht Treaty also implies that the monetary union can be run without a large central budget, since fiscal policy has clearly been left in the hands of the member states. We doubt that there are great gains to be reaped from an enhanced coordination of national fiscal policies for anti-cyclical purposes; but even if this activity were entrusted to the Union, it would not seem to require a large budget.[2]

2.1 Agriculture

Turning to the common agricultural policy (CAP), there is broad agreement that all subsidies and price support should be phased out and replaced by direct payments to farmers and rural development policies. It is also clear that the member states are in a better position than the Union to execute this 'new' agricultural policy, which basically entails decisions affecting inter-personal redistribution and local development.

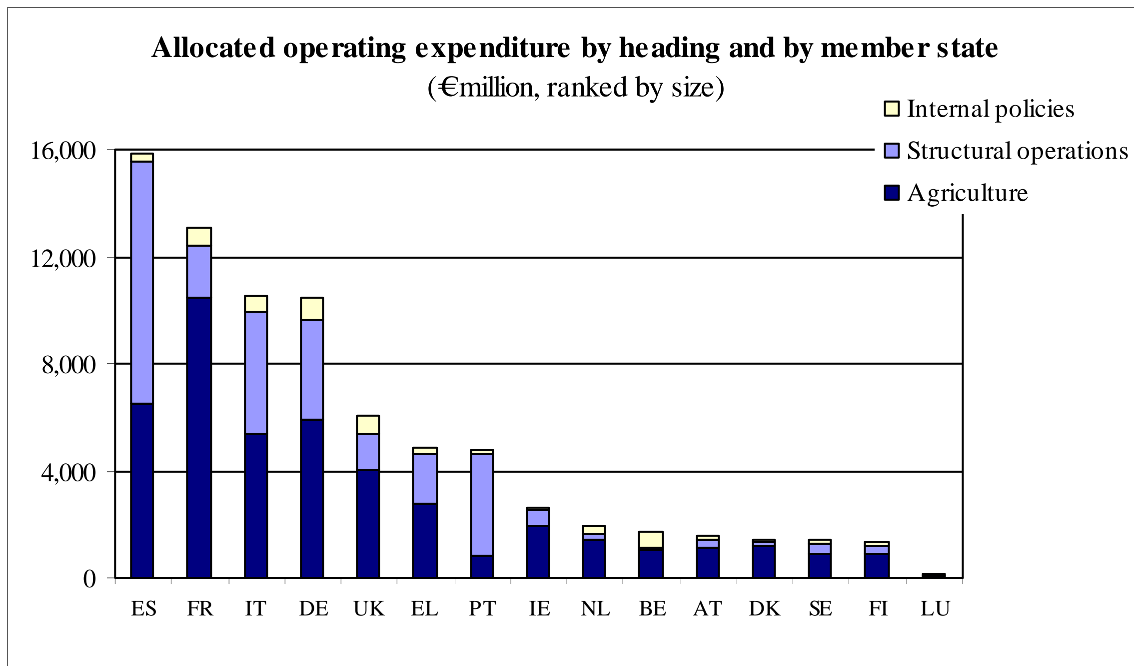
It should also be noted that agricultural spending is a major distorting factor in the EU economy and a distinct obstacle to the implementation of the Lisbon agenda. The new members of the Union are likely to suffer most from its continuing existence, since the CAP pushes relative prices and incomes in favour of agriculture and thus discourages investment in industry and services, where the potential for technical progress and productivity increase is much larger. Moreover, the Union external actions for development aid are made ineffective and crippled politically by the barriers to agricultural trade maintained because of the CAP.

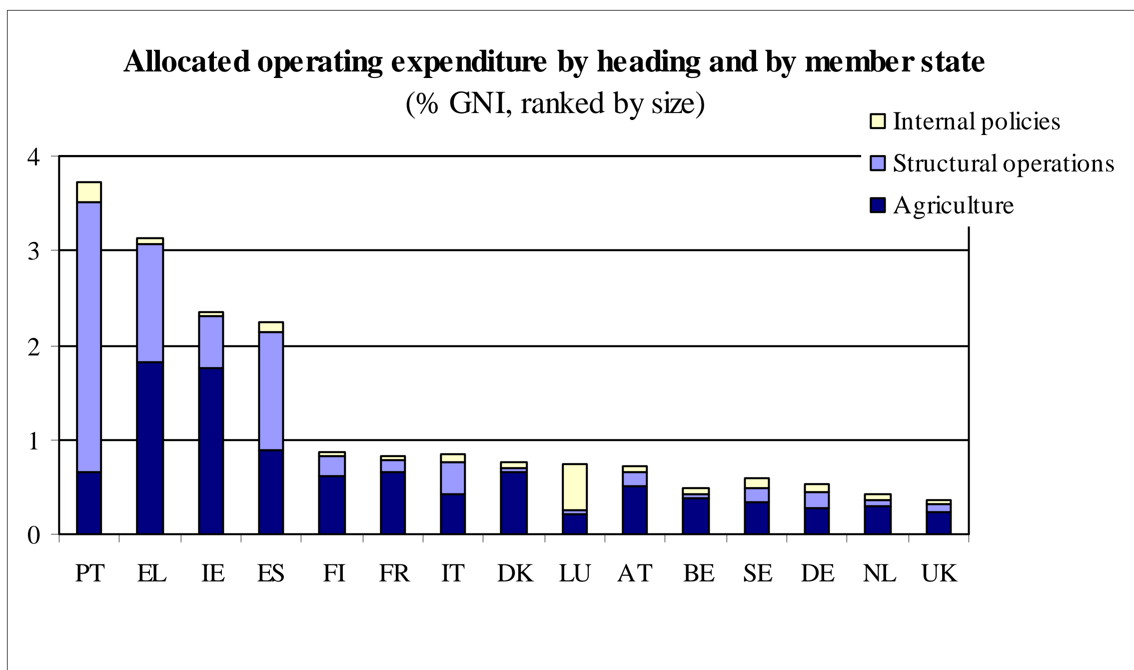
Historically agricultural spending has been a major source of tension between the member states, due to the skewed distribution of payments (Figure 1) and their impact on countries' net balances vis-à-vis the EU. Payments to French farmers alone make up almost one-quarter of total CAP spending; together, French, German and Italian farmers take away about one-half of the total, or one-quarter of the entire EU budget. As may be seen from Figure 2, there is a strong positive relationship between agricultural spending and the size of countries' net balances with the Union. Agricultural spending undermines the legitimacy of the Union budget amongst the member states and their citizens. Phasing out the CAP will help restore a climate of solidarity and shared interest in the future negotiations on the budget and the new budgetary rules.

[1] Formally this agreement set a ceiling on agricultural spending. Politically it has been interpreted, at least in France, as setting a floor. Parliament has implicitly accepted this agreement; it should now emphasise that it has accepted it as a ceiling. See Annex 2 for more details.

[2] Cyclical stabilisation could be undertaken simply by coordinating national budgets, as advocated by many authors. Asymmetric shocks could be dealt with by establishing a common insurance fund to provide appropriate (temporary) financial assistance to countries hit by them.

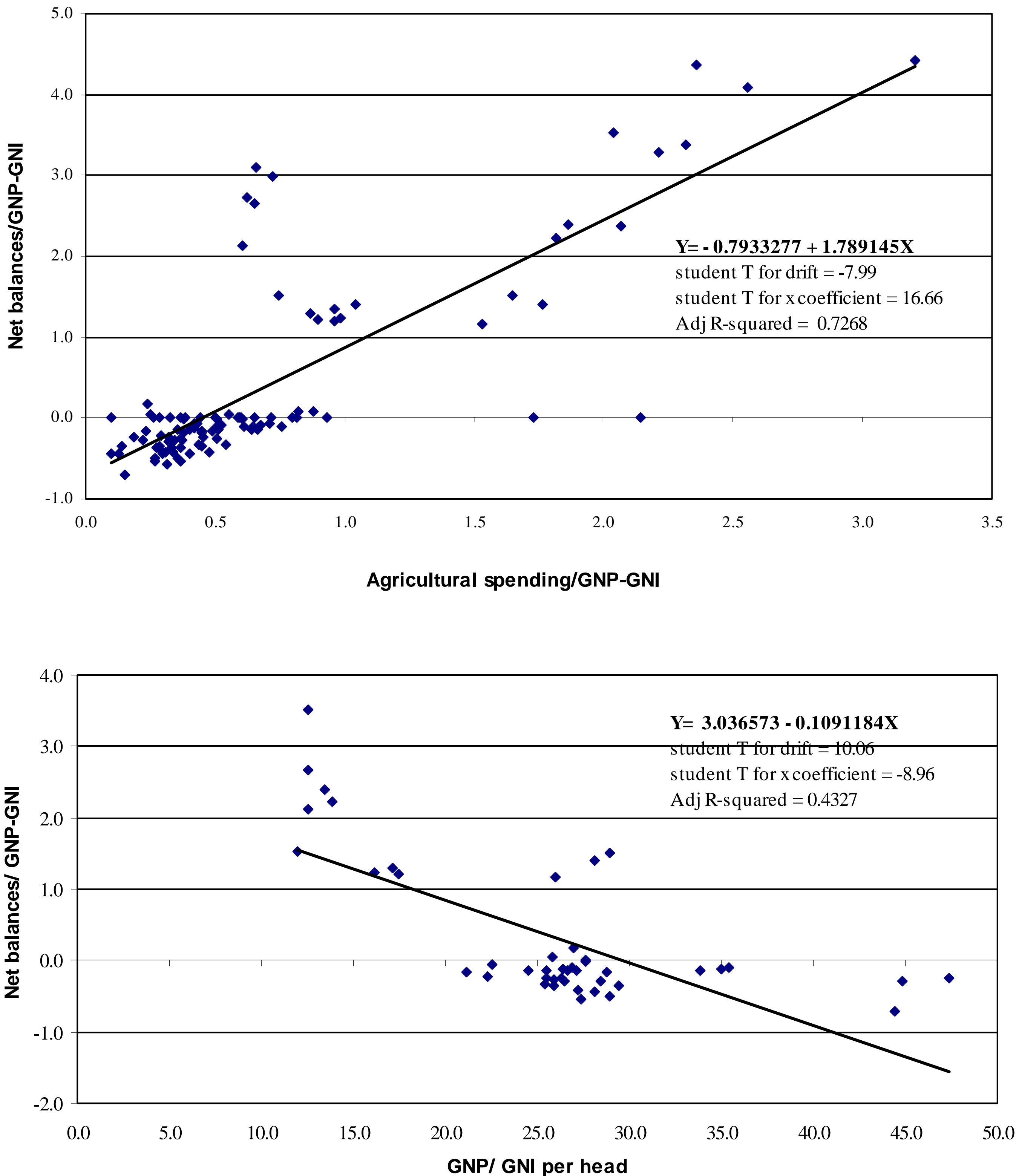
Figure 1. EU expenditure allocated by member state in 2003





Source: European Commission, September 2004.

Figure 2. The relation between member states' net balances vis-à-vis the EU agriculture spending (upper chart) and GNP/GNI per head (lower chart) (pooled cross section and time series, 1997-2003)*



* Since 2002, GNP has been replaced by GNI in the EU budgetary and own resources area in accordance with Council Decision No. 2000/597.

Source: European Commission, September 2004.

2.2 Structural Funds

When the Internal Market programme was launched and the plans for EMU began to take form, it was argued that the European Union needed to compensate poorer member countries for agreeing to these steps, leading to a large increase in structural fund support for the poorer countries and regions of the Union (see Table 1).

The implicit assumption was that the poorer member countries took a risk by exposing their weaker economies to the full competition resulting from the internal market and by agreeing to plans for a common currency, which would require budgetary efforts on their part. Experience has shown, however, that weaker economies actually benefit more from the internal market and the introduction of the euro. And the empirical evidence suggesting that EU structural funds have, on average, accelerated economic convergence of poor regions is weak. Nevertheless, this result hides opposite cases of remarkable success and utter failure, indicating that the way structural funds are spent and the economic context where they are injected make a whole lot of a difference.

Moreover, structural funds represent a visible commitment to the value of economic and social cohesion within the Union, underpinned by Treaty recognition. This concrete expression of solidarity between the member states and their people is also necessary for an effective functioning of the Union's political institutions.

Accordingly, while financing under this heading should continue to exist, it should also be clear that support cannot last forever and should be phased out as countries enjoy rising standards of living as a result of integration. To this end, eligibility should be based on objective and transparent criteria of relative economic and social development, as already heralded by Agenda 2000, as well as include incentives to reward best performers. Objective eligibility criteria carry the additional desirable consequence that the funds obtained by each country are influenced, but not directly determined by political negotiations among the member states, helping to enhance the perception of structural funds policy as a European public good.

Table 1. Appropriations for commitments (annual average) in the multi-year financial perspectives (1988-2013)

	DELORS I[a] 1988-92		DELORS II[b] 1993-99		AGENDA 2000[c] 2000-06		NEW MYFP 2007-13	
Appropriations for commitments	Mio ECU	% EU	Mio ECU	% EU	Mio €*	% EU	Mio €	% EU
1. Agriculture	28,440**	58.1	36,503	48.2	42,534	46.1		
CAP	*28,440***	*58.1*			*38,196*	*41.4*	*43,011*	*29.4*
Rural development and other					*4,339*	*4.7*	*14,797*	*10.1*
2. Structural operations	10,628	21.7	25,200	33.3	30,430	33.0		
Cohesion fund			*2,164*	*2.9*	*12,104*	*13.1*	*49,273****	*33.6*
Structural funds			*23,035*	*30.4*	*27,859*	*30.2*		
3. Internal policies	1,862	3.8	4,512	6.0	6,261	6.8	21,609	14.8
Competitiveness for growth and employment							*18,965*	*13.0*
Citizenship, freedom, security and justice							*2,644*	*1.8*
4. External actions	2,498	5.1	5,200	6.9	8,100	8.8	13,656	9.3
External actions	*2,498*	*5.1*	*4,629*	*6.1*	*4,580*	*5.0*		
Emergency aid			*271*	*0.4*	*200*	*0.2*		
Loan guarantees			*300*	*0.4*	*200*	*0.2*		
Pre-accession aid					*3120*	*3.4*		
5. Administration	4,540	9.3	3,640	4.8	4,809	5.2	4,089	2.8
6. Monetary reserves	1,000	2.0	643	0.8	179	0.2		
Total	48,968	100	75,698	100	92,313	100	146,434	100
Appropriations for payments	46,936		72,177		91,643		132,671	
Appropriations for payments (% of GNP)	1.15		1.22		1.07		[GNI]1.14	
Own resource ceiling (% of GNP)	1.18		1.23		1.27		[GNI] 1.24	

[a] Heading 3 included multi-year policies (R&D, IMP); Heading 4 included "other non-compulsory policies".
[b] Heading 3 included R&D, TENs, environment and the functioning of internal market.
[c] Internal policies includes: training, youth culture etc.; energy, nuclear and environment; consumer protection, internal market etc.; research and technological development, other internal policies.

* 1 ecu = 1 euro.
** Allocation for EAGGF, section guarantee only.
*** Cohesion and Solidarity funds included.

Sources: European Commission and authors' own estimates.

In the coming years financing requirements under this heading will decline for recipients in the EU-15, reflecting higher incomes per capita, but will have to increase to support institution-building, infrastructures and environmental upgrading in the new member states.

As for policies specifically designed to raise growth, the Sapir Report (Sapir et al., 2003) has argued that a new heading should be created in the European budget, with substantial resources for trans-European infrastructure networks and research. The Commission proposal for the new MYFP 2007-13 has taken up the proposal.

Indeed, public policies can play an important role in raising productivity, growth and employment. However, larger public spending will not work, unless there is an economic and social environment open to competition and favourable to risk-taking and change. The dismal growth performance of the European economy in the past decade – mainly reflecting the French, German and Italian economies – is by and large the result of rigid labour and capital markets, baroque institutions that block entry and competition, and massively distorted incentives. In these circumstances, higher public investment would not succeed and would feed inefficiency and waste.

It should also be borne in mind that resources available in the budget of the Union for public investment are a tiny fraction of member states' spending under these headings and, more importantly, that the rules and decisions that determine the outcome of these public programmes are adopted by national governments back home. Therefore, the European Union can in the main play a role as a catalyst of better policies, including better spending, at national level; its success will depend on national policies following suit.

2.3 A new focus: R&D?

The one area where this conclusion might be challenged is research and development, which constitute a typical public good whose benefits extend far beyond national boundaries. Moreover, recent research suggests that R&D is a key growth factor. This combination of ideas was behind the emphasis in the Lisbon agenda on the 'knowledge society'. To what extent the public goods nature of R&D actually can provide a rationale for large-scale spending at the EU level is discussed in more detail in Annex 1.

The main conclusion is that a substantial increase in the funds for research in the EU budget is justified. More money is needed for funding public and private research centres and networks of excellence in all sciences, and to greatly enhance the mobility of researchers.

But more resources cannot be justified unless EU funds are spent more productively. The present system – whereby priorities in the Framework Programmes are the result of political negotiations in the Council and funds are disbursed by the European Commission – should be abandoned, because it leads to a wasteful multiplication of priorities and fragmentation of grants. The Union should also abandon the direct funding of own research outfits that inevitably fall prone to bureaucratic management and political influences. The Joint Research Centre, which is a major drain on scarce resources and a source of waste, should be dismantled.

A new 'European Science Agency', shaped on the example of the US National Science Foundation, should be set up to foster scientific excellence, identify priority areas for research and ensure the highest standards in project selection. The establishment of public and private European research centres and networks of excellence should receive strong support, and high priority should be placed on fostering researchers' mobility.

However, increased EU funding alone cannot bring European R&D to the level required to allow the Union to realise its goals about the 'knowledge society'. Over 95% of all R&D spending in Europe remain at the national level. Moreover, as shown in Annex 1, R&D spending in Europe yields a much lower return in terms of commercially exploitable ideas. The main problem is to make European research spending more effective, and the key step to take to this end is to open the market for research funds. Not only EU R&D funding, but also national funding should be opened to competition Union-wide, including all national science support programmes.

2.4 New areas: Internal and external security

Then, it is useful to consider other new functions ('public goods') that the Union usefully can, and must, take up on a much larger scale.

Indeed, the European Union is clearly moving beyond the scope of a pure 'economic union'. Over the last few decades it has been steadily adding elements of political integration by moving into such areas as internal and external security and foreign policy.

With the free movement of people within the EU, the need for a common approach to guarding external borders and combating international crime has become evident. While only some first timid steps have been taken in building what is called the European common Area of Freedom, Security and Justice, it is clear that over time common institutions will be required in this field. The sheer force of numbers[3] strongly suggests that a European FBI, a European Border Guard and a European prosecutor might well be operating by the time the next MYFP are discussed in the 2010s.

Moreover, the economies of scale present in the field of external security have been forcefully illustrated in recent conflicts, from Kosovo to Iraq. When member states do not coordinate their policies and pool their means, the Union

[3] In an EU-27, a matrix of bilateral liaison officers among national policy agencies has over 700 different points of contact.

does not count. Progress here has been even slower in this area, but many signs indicate that it is speeding up.

It is ironic that the EU spends the least in these areas when survey after survey of public opinion confirms strong citizens' support for greater Union involvement.

2.5 Provision of European public goods as the guiding principle for the EU budget

This brief discussion suggests one guiding principle for the EU budget: expenditure at the EU level is appropriate only to safeguard a European public good. Over time, this simple principle should become fully reflected in the structure of the EU budget. There is no justification to spend for decades a major part of the EU's scarce resources on a declining industry such as agriculture. Substantial resources will have to continue to be devoted to promoting income convergence, which is needed to preserve the political cohesion that allows the EU to work efficiently. The role of the Union in fostering productivity, growth and employment should increase, with strong focus on human capital and research.

And substantial resources will be needed for the Union to play its full role in the world and be able to provide strong security inside and outside its borders.

Altogether, this does not seem to require a major increase in the Union's resources. One percent of aggregate GDP/GNI seems to provide adequate margins for the Union to perform effectively the tasks that have been described. This is true, provided that we are able to put money where it is needed, rather than continuing to yield to the demands of organised interest groups.

3. How to finance the EU budget?

At present the budget of the Union draws its resources from custom and agricultural levies (traditional resources), a VAT resource levied on a 'notional' harmonised VAT base,[4] and a 'fourth' resource based on gross national income (GNI). The latter plays a residual role: its amount is determined ex-post so as to fill the gap between actual spending and the revenues flowing from the traditional and VAT resources. This residual is then allocated amongst the member states in proportion to their share in the Union's GNI, and is paid by each member state out of its national budget. As may be seen from Table 2, by 2005 this GNI resource has come to represent three-quarters of total revenues.

The fact that the GNI resource dominates revenues is in flat contradiction with the EC Treaty. Art. 269 prescribes that "the Union shall be financed wholly from own resources". By contrast, under the present system the vast majority of Union resources comes from well-identified contributions from national budgets, which the member states inevitably consider 'their money' and want to compare with 'their' receipts from the EU budget.

Table 2. EU-15 own resources, 1996-2005

Percentage share of revenues:	1996	2000	2005
Traditional	19.1	17.4	11.4
VAT	51.3	39.9	14.1
GNP/GNI	29.6	42.7	74.5
Total own resources (€billion)	71.1	88	108.5

Source: European Commission.

Indeed, as has been noted, for any individual member country, the return from defending an EU-wide, encompassing interest is dwarfed by the advantage it can obtain from a change in the budget in its own favour, even if this leads to lower overall efficiency.

This perverse incentive structure applies even to the largest member country, Germany, which accounts for a little less than a quarter of the budget and EU population. For Germany the return from spending efficiently one euro on some EU-wide interest would be around 25 cents, only a quarter of the return of any one euro spent in Germany. Thus, if the German government has the choice between more spending on a European public good and more spending on something that mainly benefits German interests, it will always chose the latter.

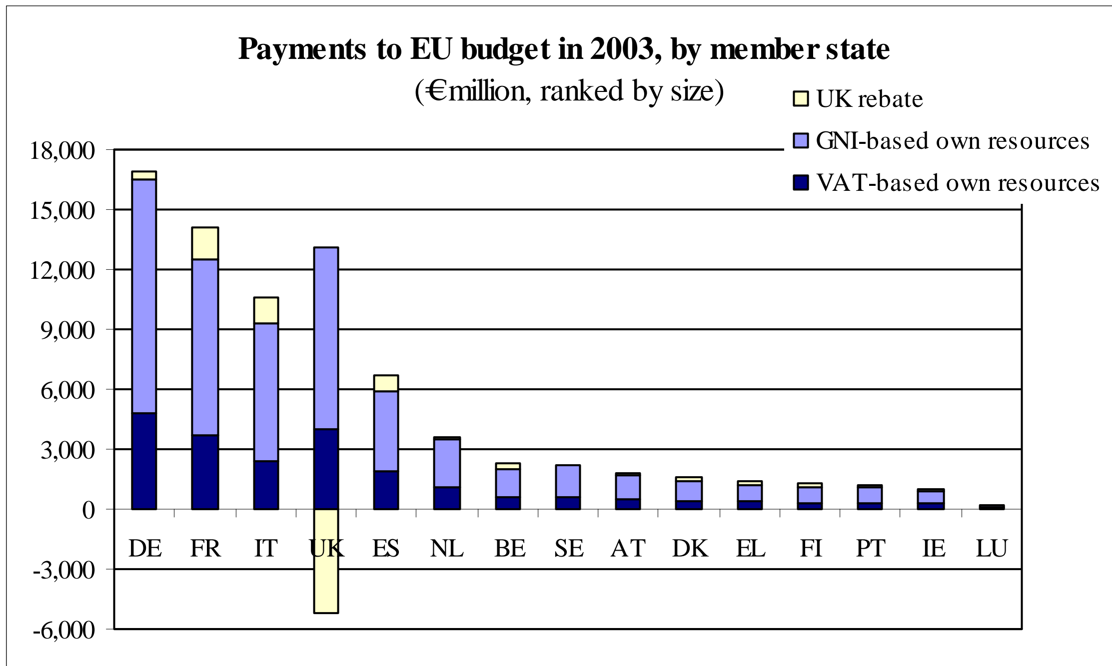
The same reasoning applies with even more force to the other member countries whose stake in the EU budget is smaller. Moreover, the problem grows with each successive enlargement because each time the stakes of individual member countries in the budget become smaller and smaller. For example, the largest new member country, Poland, has a share in the EU budget of less than 5% and a population share below 10%.

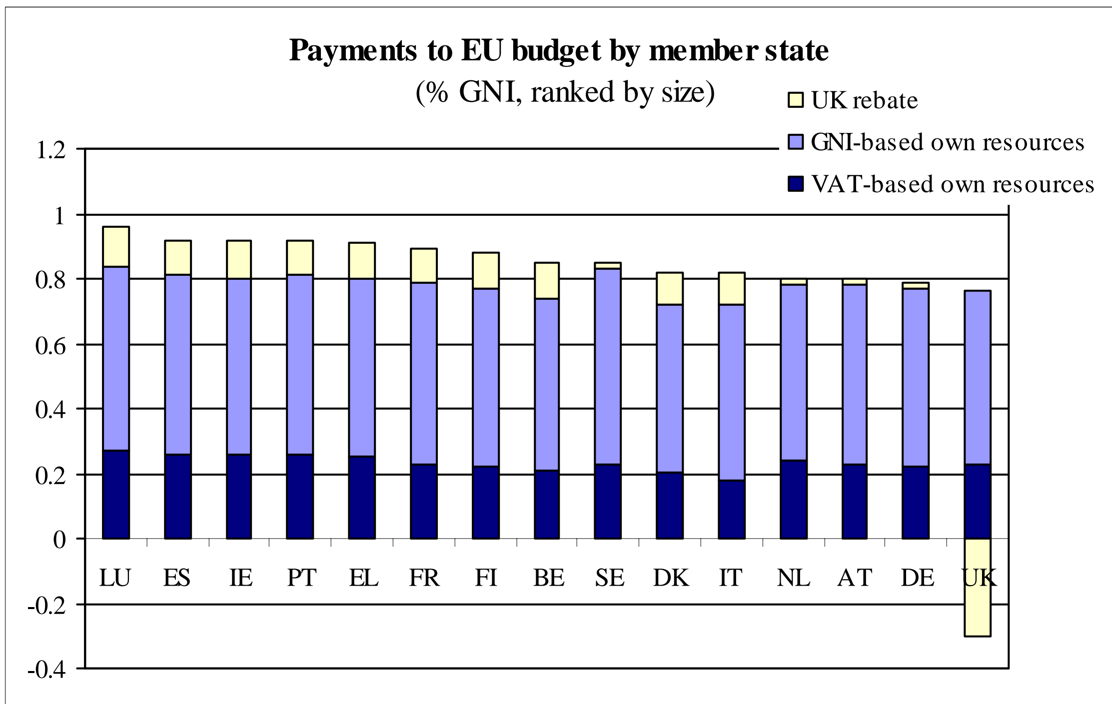
Therefore, it is not surprising that the new member countries concentrate their efforts in diverting EU transfers to their own citizens while preserving the present budget structure.[5] The skewed distribution of payments to the member states under the CAP and the structural fund programmes only aggravates the problem.

[4] The base is calculated on the basis of national VAT receipts and capped at 50% of each member GNI so as to correct for the allegedly regressive nature of VAT. In practice, when capping applies, this resource is turned de facto into a GNI-based resource. Since 2002 the VAT call rate for the Union is 0.5%.

[5] The political importance of the contribution to the EU is heightened in countries with a federal fiscal system. For example, in Germany the revenues of the federal government amount only to around 20% of GDP. This implies that a contribution to the EU equivalent to 1% of GDP accounts for 5% of the revenues of the federal government in Germany. In other countries where the revenues of the central government are a much higher proportion of GDP, the relative importance of the contribution to the EU budget for the central governments is smaller, even with similar contributions to the EU budget as a share of GDP.

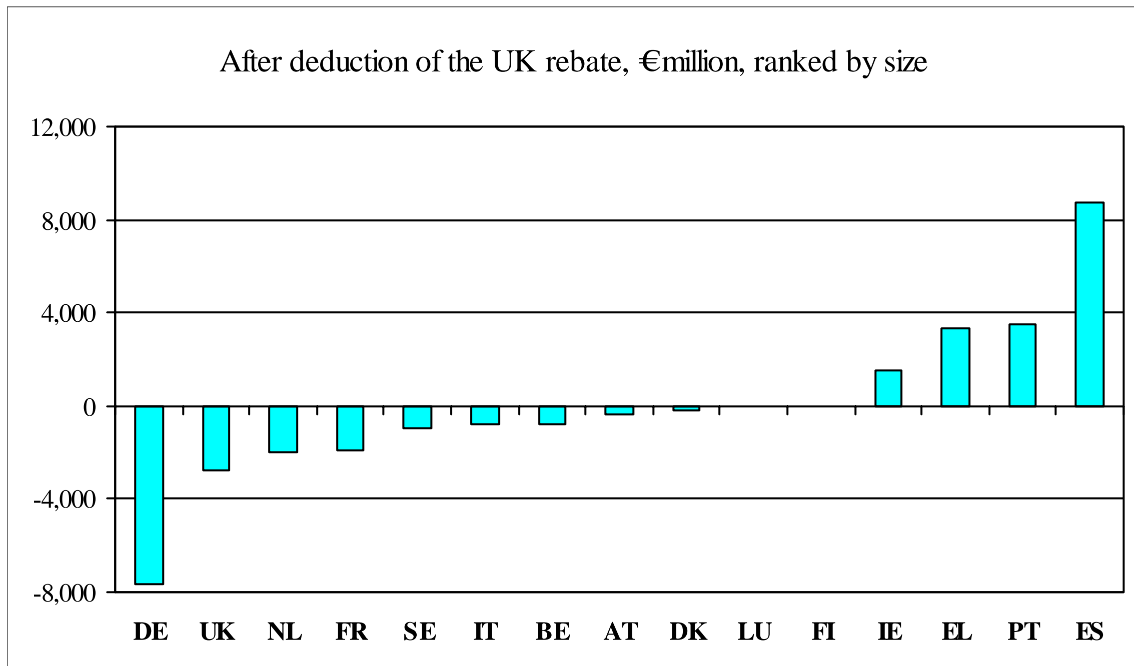
Figure 3. Payment to EU budget by member state in 2003

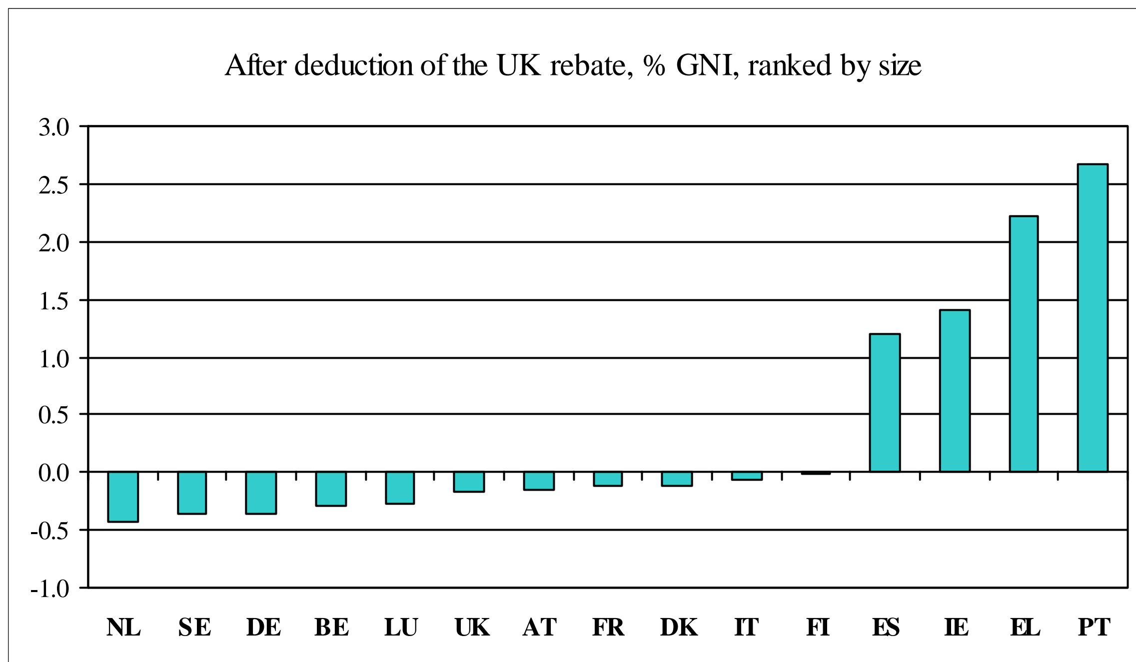




Source: European Commission, September 2004.

Figure 4. Operational budgetary balances in 2003





Source: European Commission, September 2004.

Table 3. EU-15 allocated expenditure, payments to EU budget and budgetary balances by member state (annual averages 2000-2003)

	EU allocated expenditure						Payments to EU budget[d]		Balances		GNI per head
	Total[a]		Agriculture[b]		Structural Operations[c]		Total				
	Mio €	% EU TOT	Mio €	% EU AG	Mio €	% EU SO	Mio €	% EU TOT	Mio €	% GNP-GNI[e]	Th. €(2003)
Belgium	1,814.3	2.48	967.4	2.28	225.8	0.89	2,312.4	3.16	-498.0	-0.19	26.5
Denmark	1,449.5	1.98	1,217.1	2.86	83.4	0.33	1,540.8	2.11	-91.3	-0.05	35.0
Germany	10,611.5	14.52	6,056.6	14.26	3,651.5	14.35	17,593.4	24.05	-6,981.9	-0.34	25.9
Greece	5,200.0	7.12	2,652.8	6.24	2,370.1	9.32	1,273.9	1.74	3,926.1	2.95	13.8
Spain	13,883.6	19.00	6,032.1	14.20	7,531.7	29.60	6,209.2	8.49	7,674.4	1.16	17.4
France	12,109.8	16.57	9,620.4	22.65	1,813.4	7.13	13,822.4	18.89	-1,712.6	-0.11	26.4
Ireland	2,526.7	3.46	1,739.1	4.09	704.3	2.77	1,010.1	1.38	1,516.6	1.46	28.1
Italy	9,497.5	13.00	5,370.2	12.64	3,557.3	13.98	10,605.2	14.50	-1,107.7	-0.09	22.5
Luxembourg	122.3	0.17	33.7	0.08	7.7	0.03	198.7	0.27	-76.4	-0.38	44.8
Netherlands	1,836.8	2.51	1,282.1	3.02	244.5	0.96	3,820.5	5.22	-1,983.8	-0.47	28.1
Austria	1,467.2	2.01	1,072.9	2.53	238.4	0.94	1,853.1	2.53	-385.9	-0.18	27.1
Portugal	3,697.1	5.06	789.2	1.86	2,776.8	10.91	1,162.3	1.59	2,534.8	2.07	12.6
Finland	1,220.4	1.67	814.6	1.92	294.2	1.16	1,195.5	1.63	24.9	0.03	27.7
Sweden	1,229.2	1.68	815.6	1.92	250.4	0.98	2,160.9	2.95	-931.7	-0.38	29.4
UK	6,416.6	8.78	4,019.4	9.46	1,692.9	6.65	8,395.6	11.48	-1,979.0	-0.04	28.8
EU-15	73,082.4	100	42,482.9	100	25,442.2	100	73,154.1	100	-71.7		24.7

[a] External and administrative expenditures are excluded.

[b] Direct aid, export refunds, storage, rural development, other.

[c] Structural Funds, other specific structural operations, Cohesion Funds

[d] VAT and GNI-based own resources adjusted payments (including UK rebate). It is not the MS actual payments but the allocation key of these payments .This allocation key is applied only to total allocated operating expenditure in order for budgetary balances to add up to zero. Total payments are consequently set to equal total EU operating allocated expenditure.

[e] Data in % of GNP-GNI are calculated on ESA79 GNP data for 2000-2001 and ESA95 GNI data for 2002-2003. The concept of GNP has been replaced by the GNI in the EU budgetary and own resources area from 2002 in accordance with Council Decision No. 2000/597.

Source: European Commission, September 2004.

The problem was aggravated in the 1980s by the decision to grant the United Kingdom a 'rebate' in order to correct an otherwise unbearably large net contribution by that country, which has a small agricultural sector and displays limited eligibility for structural support (Figure 3). The UK rebate and the bitter negotiations that preceded it strengthened the perception of the EU budget as a vehicle for intergovernmental transfers, reflecting countries' negotiating strength. Over time, the fairness of the rebate has come under increasing criticism, since other member states with lower per capita income display higher net payments to the EU budget, as a ratio to their GNI (i.e. Belgium, Germany, the Netherlands and Sweden; see Table 3 and Figure 4).

On this score, enlargement will only make matters worse, since the new member states will attract an increasing share of funds at the very time when the willingness to finance the EU budget by net contributors is sharply diminished, while traditional recipients of structural funds drag their feet to delay their inevitable reduction.

As already indicated, changing this state of affairs requires that on the revenue side all links between national treasuries and the EU budget be rescinded, and the cost of Europe be made to fall directly and visibly on the citizens of the Union.

However, we must also bear in mind that, under Art. 10 of the EC Treaty, Community programmes and activities within the border of the member states are implemented by their public administrations. It is not possible, nor indeed desirable, to create a separate EU tax administration.

Therefore, the solution would be to rely on national tax systems and 'dedicate' to Europe the revenue from one particular tax. Efficiency and equity require that this tax be levied on a broad base, harmonised at EU level, at a moderate rate. A broad base also entails that special allowances on grounds of horizontal equity can be kept to a minimum, as the overall burden would continue to amount to a small share of GDP/GNI.

Since the aim is to make the cost of the EU as transparent as possible to European citizens, it is tempting to jump to the conclusion that the best way to achieve this is to add a 'Euro tax' to the personal income tax return bill that most citizens have to fill every year. However, this solution is not feasible in practice since it would lead to a highly unequal distribution of the burden, given the large differences in the national definitions of taxable income. As a result, the yield of personal income taxation varies widely across member countries, with low values around 3-4% of GDP (e.g. Slovakia and Poland) and peaks over 25% of GDP (e.g. Denmark).

Narrowness and lack of harmonisation of the base also seem to rule out, as feasible alternative, a surcharge on corporate income. The proposal of taking the money for the EU from central bank reserves does not meet the test of visibility and accountability vis-à-vis European citizens.

Most of these difficulties do not arise with the VAT. Its base has been reasonably harmonised; the rates do not differ as greatly as do those for personal income taxation; the differences in yields are relatively minor, ranging from a low around 6% of GDP in countries like Italy and Spain to a maximum of 9% of GDP in Hungary and Sweden (see Table 4).

Table 4. Private consumption and VAT (% of GDP, 2003)

	Private consumption /GDP	VAT/GDP
EU-25	58.3	7.0
EU-15	58.2	7.0
Belgium	54.5	7.0
Czech Republic	50.9	6.5
Denmark	47.2	9.7
Germany	59.0	6.5
Estonia	56.6	8.9
Greece	67.2	7.8
Spain	57.8	6.3
France	55.5	7.2
Ireland	45.2	7.2
Italy	60.4	6.1
Latvia	63.0	7.3
Lithuania	64.9	6.9
Luxembourg	41.9	6.5
Hungary	54.7	9.1
Malta	60.8	7.1
The Netherlands	48.4	7.7
Austria	56.1	7.9
Poland	66.0	8.2
Portugal	62.3	8.5
Slovenia	54.4	8.9
Slovakia	55.3	6.8
Finland	52.3	8.6
Sweden	48.7	9.2
UK	65.5	7.1

Source: Eurostat, 2005.

A flat rate of around 2% throughout the Union should be sufficient to finance a EU budget of about the present size (1% of GDP). The receipts for all purchases subject to VAT would show the amount paid to the European Union, thus making citizens aware of their contribution. The VAT receipts pertaining to the Union would be transferred automatically and continuously to Union accounts, as they accrue to VAT offices in the member states, and would no longer be shown on national budgets. The burden on national budgets would change only marginally, since lower receipts on account of VAT would be largely offset by lower payments to the EU budget under the GNI resource.

Under this proposal, ideally the EU budget would be covered by only one tax, with clear benefits of transparency and visibility. However, Art. 268 requires the budget of the Union always to be 'in balance'. Therefore, some mechanisms for ex-post adjustment of revenues in light of

actual spending, such as the existing GNI resource, has to be maintained. This mechanism, however, should amount to no more than a small shock absorber to make up for unforeseen differences between actual revenues and expenditures, with net excesses and shortfalls of spending shared on the basis of shares in overall GNI.

An EU VAT surcharge would lead to a reasonably even distribution of the burden, and would not necessarily be regressive. Traditionally, the view has been held that poorer countries have higher consumption as a proportion of income, and hence a relatively larger VAT base. However, the data in Table 4 indicate that among the countries with high VAT revenues one finds both rich (Sweden) and poor (Hungary); the same applies to countries with low VAT revenues in proportion to GDP (e.g. Spain, a cohesion country, and Italy, with GDP per capita above the EU average).

Introducing a European VAT surcharge would not immediately eliminate the view taken by governments that the most important aspect of the EU budget is the national 'net balance', because governments would probably consider that the contributions made by their citizens towards the EU budget should just be seen against the benefits their citizens and enterprises receive. But the amounts contributed to the Union would no longer appear on national budgets, and the EU citizens would have a direct feel of how much they have to pay for common policies.[6]

An issue that needs to be decided is whether a correction mechanism for net imbalances that appeared disproportionately large should be maintained. On this, the Commission has proposed to discontinue the present 'UK only' rebate and to replace it with a generalised correction mechanism whereby any emerging large imbalance would be trimmed down and the burden would be spread out among the other EU member states.

It is interesting to note in this regard that, within the EU-15, net imbalances have tended to shrink over time, reflecting reduced structural support, due to the convergence of income per capita, and lower payments under the CAP (Table 5). Figure 5 shows that between 1993 and 2003, the relationship between net imbalances and differences in per capita income within the EU-15 has grown less steep. This appears to be mainly a consequence of the reduction in agricultural payments.

Table 5. EU-15 net balances 1993-2003 (averages over stated periods as a percentage of GDP/GNI)

Country	1993-96	1996-99	2000-03
Belgium	0.03	-0.17	-0.19
Denmark	0.31	0.05	-0.05
Germany	-0.65	-0.55	-0.34
Greece	4.50	3.92	2.95
Spain	1.13	1.28	1.16
France	-0.14	-0.11	-0.11
Ireland	5.40	4.06	1.46
Italy	-0.18	-0.15	-0.09
Luxembourg	-0.54	-0.47	-0.38
The Netherlands	-0.25	-0.49	-0.47
Austria	-0.35	-0.36	-0.16
Portugal	3.17	3.09	2.07
Finland	-0.06	-0.09	0.03
Sweden	-0.41	-0.48	-0.38
UK	-0.13	-0.19	-0.04
Standard deviation	1.94	1.66	1.04

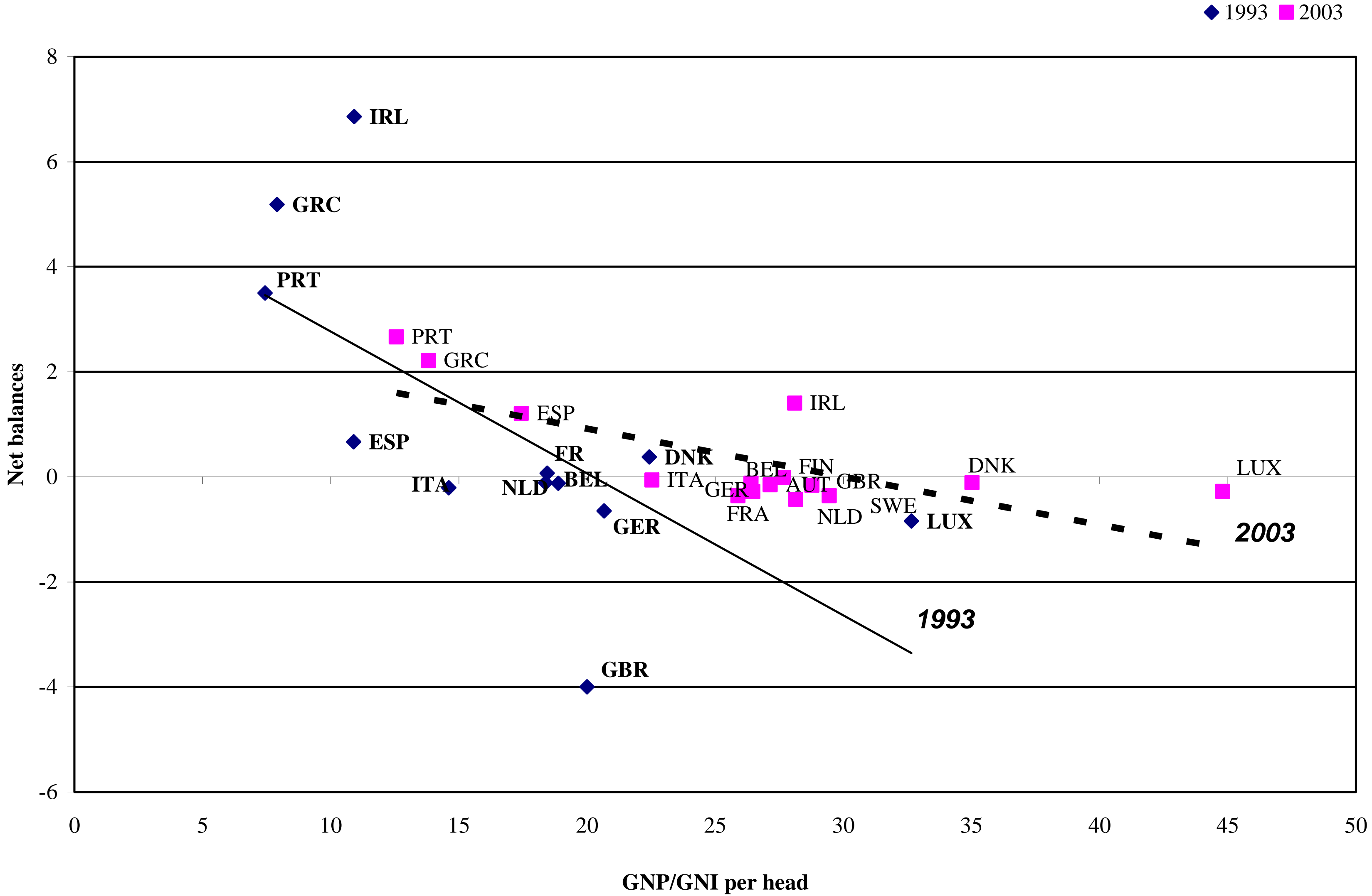
Source: European Commission.

Thus, the straight answer is that – once the CAP is phased out – a correction mechanism for net imbalances is no longer needed. The reason is two-fold. First, with the CAP out of the way, spending under the EU budget could legitimately be considered as a genuine expression of public preference for European public goods. Second, with a European VAT surcharge financing the whole budget, the cost of European public goods would be borne by all countries and their citizens, roughly in proportion to their consumption spending and incomes. (see Figure 3, lower quadrant).

The elimination of the UK rebate, without any other mechanism taking its place, would be another important contribution to breaking the link between national treasuries and the EU budget.

[6] As an aside, one might note that in general it does not matter whether one uses GDP or GNP as the base for the ability of a country to contribute to the EU (and be eligible for Structural Funds) since for most countries the difference between GDP and GNP is minor, less than 1%. The one important exception is Ireland, where GDP is about 20% higher than GNP. This is attributable to the fact that a large proportion of the value added produced in Ireland (measured by GDP) originates in enterprises owned by foreign firms. This is a consequence of the large amount of FDI Ireland has received over the last decades. Some of the new member countries might soon experience a similar phenomenon since they are also receiving a sustained large inflow of FDI.

Figure 5. Net balances and GNP/GNI per head in 1993 and 2003 (thousands of ecu and euro)
Scatter plot and linear regression



Source: European Commission, 2003 and 2004.

4. Overhauling decision-making

Decision-making procedures play a central role in preserving the anachronistic structure of the budget that has been described, and should therefore be changed. See Annex 2 for an historical chronology of budgetary decision-making.

The EC Treaty has explicit provisions for deciding the system of own resources and the yearly budget, but not the MYFP, which is where all the key budgetary decisions are taken.

The system of own resources is decided by the Council by unanimous vote, based on a proposal by the Commission and after consulting the Parliament. The decision thus taken is then recommended for adoption by the member states "in accordance to their constitutional requirements" (Art. 269).

Decisions on the yearly budget are taken by Council (by qualified majority) and Parliament (by absolute majority) together (Art. 272); Council has last say over 'compulsory' expenditures,[7] which notably includes the CAP, and Parliament has last say over the rest of the budget. The budget has to cover all expenses of EU institutions (universality) and must always be in balance. The Commission prepares the preliminary draft budget, but subsequently has no formal role in the decision. Nevertheless, it is responsible for executing the budget.

The system of the MYFP was agreed at the end of the 1980s, after years of bitter contests between Council and Parliament that had led to paralysis and in two instances to rejection of the budget by Parliament (in 1979 and 1984). Under this new system, the Council fixes by unanimity the MYFP for a period between five and seven years, which include annual ceilings for total resources and the main headings of spending. The initial proposal is prepared by the Commission, but the Council may modify it as it wishes. The European Parliament negotiates with the Council and then votes a resolution, by simple majority, accepting the Council decision. In practice, it has had little influence on the main figures – for the CAP and structural spending – but has used the opportunity to extract concessions concerning its own interests, e.g. the influence of the EP in other areas.

The MYFP are then enshrined in an inter-institutional agreement that binds Council, Commission and Parliament to 'loyal cooperation' in yearly budgetary decisions, and notably to respect yearly expenditure ceilings.

It should be noted that these arrangements are not codified in any legal document setting out budgetary procedures, but are renewed by consensus by the three institutions at the expiration of each MYFP.

There are three main drawbacks in this system. First, the yearly budget – which is the instrument with legal value under the Treaty – is not the real seat of budgetary decisions, which are taken elsewhere. Second, all significant decisions are in practice taken by the Council, outside the Community method and based on intergovernmental negotiations where every member state pursues mainly national interest and has veto power. Third, the MYFP are adopted for time periods that are completely disconnected with the time interval of legislatures and Commission tenure.

The Constitutional Treaty will improve this situation considerably, but more could be done. Under the Constitutional Treaty, the MYFP will take the form of a European law of the Council, still decided by unanimity, after obtaining the consent of the European Parliament. The Commission has no formal role of proposal. Furthermore, the category of compulsory expenditures has been suppressed, thus broadening the Parliament's vetting to include the entire yearly budget. See Annex 3.

Clearly, the Union will not have a proper budget, as an expression of its priorities and policy goals, until both the MYFP and the yearly budget are decided by Community method, that is by co-decision of Council – deciding by majority vote – and Parliament, based on a legally binding Commission proposal. However, this decision-making power should not extend unchecked to the decision on the total resources ceiling, since the latter impinges on national parliaments' taxation powers. Moreover, the European Parliament is likely to have a bias in favour of more spending at the European level.

As we have argued, there are a number of areas where the greater European interest might best be served not by more spending at the EU level, but by other measures, for example increasing competition or coordination of national policies. A counterweight is thus needed.

One way to do this would be to leave the last word on total resources to the Council, but let the European Parliament determine their allocation across categories of spending. Such a distribution of competences is likely to lead to a useful implicit negotiation in which the allocation of spending proposed by the European Parliament would be accepted by the Council to the extent that it reflected European interests and 'value for money'. Were this not the case, the Council would reject the demands for a higher resource ceiling, and cut it to size.

Another beneficial change, which does not require a change in the Treaty, would be to synchronise the reference period for the MYFP with the terms of office of the Parliament, so as to strengthen the interrelation between budgetary decisions and the results of the European elections. The MYFP should run for five years, and enter into force one year after the election of a new Parliament, to allow it sufficient time to deliberate after election.

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[7] Compulsory expenditures are only obliquely referred to in Art. 272, para. 9, of the EC Treaty: "A maximum rate of increase … shall be fixed annually for the total expenditure other than that *necessarily resulting from this Treaty or from acts adopted in accordance therewith"*. The precise classification of expenditures falling within this category can be found in annexes to the inter-institutional agreements.

With this change, the content of the MYFP would become a main theme in the campaigns for the election of the European Parliament, with a likely increase in voters' interest in the elections and their turn out.

A new change in the Treaty will not be feasible until 2009. However, already now, the Parliament could send out the right political signals, once it starts its own work on the new MYFP. It should tell the Council that it will accept whatever ceiling member states put on overall spending, but at the same time that it will expect to have a main say over the composition of spending, and it should indicate what expenditures it considers a priority.

In this game of self-restraint, the Parliament, by accepting the ceiling on total expenditures, will gain credibility with governments and the electorate. In exchange, it will have affirmed its role in deciding what European public goods should come from the Union budget.

5. A budget that fosters European interests

The considerations that have been developed so far point to the need for a radically different European budget, one that would really foster European interests.

An example of such a changed budget was prepared by the Sapir Report. Rather than providing precise euro amounts, they expressed each heading as a percentage of the total yearly budget over the MYFP period.

In Table 6 we have followed the same approach to present our figures. In order to make clear where we differ, we have included the budgets outlined by the Sapir Report and the proposal tabled by the Commission for the new MYFP 2007-13. At the bottom of the table, for reference, we provide a notional amount in euro of the total budget, based on the GDP estimates for 2007-13 used by the Commission for its proposal.

The Sapir Report assumed that the EU budget would be limited to 1% of aggregate GDP. As may be seen, they already propose to abandon the CAP and to concentrate resources on two main headings devoted to "growth and competitiveness" (45% of the total) and "convergence" (40% of the total). No allowance is made for the new public goods of internal and external security. The lion's share of "growth" funds (25%) is assigned to R&D and sizeable resources are reserved for infrastructures and a much strengthened common action for education. The latter appears somewhat excessive, in view of the need to meet the tests of Community value added and subsidiarity. As to "convergence" funds, the main indication is that two-thirds should be reserved for new entrants and one-third for old members in the EU. Some "restructuring" funds are earmarked to assist the mobility of displaced workers and phase out agricultural expenditure.

Table 6. Options for the EU budget (percentages of total budget)*

Appropriations for payments	Sapir Report	Commission**	Our budget
Growth & competitiveness	45.0	13.0	37.5
R&D	*(25.0)*	*(4.0)*	*(25.0)*
Infrastructure	*(12.5)*	*(8.0)*	*(10.0)*
Education	*(7.5)*	*(1.0)*	*(2.5)*
Structural adjustment	-	10.0	-
Agriculture	15.0	30.0	-
Convergence	40.0	35.0	40.0
Environment	-	-	*(10.0)*
Foreign policy and external actions	-	10.0	7.5
Freedom security and justice	-	2.0	7.5
Defence	-	-	7.5
Total	**100**	**100**	**100**
Own resources ceiling (% of GNP)	1.00	1.24	1.00
VAT resource	-	0.25***	0.95
GNI (residual) resource	-	0.75	0.05
Notional yearly amount (€billion)	115	145	115

* The figures in the first two columns are adjusted to make them comparable with our proposal and, due to lack of precise information on underlying estimates for budgetary sub-headings, can only be considered rough approximations of actual numbers. The Commission data are based on its proposals for the MYFP 2007-13.

** The Commission figures have been obtained as averages of yearly figures for appropriation commitments for the period 2007-13. Minor adjustments have been made in order to facilitate comparison: for example administrative expenditures have been allocated proportionately among the various budgetary headings and are not reported.

*** This figure also includes other traditional resources from customs and agricultural levies.

The Commission proposal for the new MYFP interprets the agreement on CAP as a floor, rather than as a ceiling, and thus maintains the support to agriculture under the CAP at current levels until 2013, but posits a large increase in total resources, to 1.24% of GNI. Thus, the share of direct agricultural support in total spending falls to around 30%, and larger resources are devoted to convergence (35%), growth and competitiveness (13%) and external actions (not present in the Sapir Report exercise). A small allowance is also made for action under the heading of freedom, security and justice. A substantial amount – some 10% of the budget – is reserved for external action, mainly development assistance to poorer countries; unfortunately, much of this money is of little use to foster development, as long as the agricultural exports of poor countries are denied access to European markets owing to the CAP.

The main difficulty with the Commission proposal, of course, is that the member states do not seem willing to raise the resource ceiling to 1.24%; indeed a number of countries have proposed that the ceiling be lowered to 1%. But in this case, the invariance of agricultural spending would leave insufficient room to accommodate the competing demands for structural funds by old and new member states and the badly needed expenditure for growth and cohesion. Once again, 'bad money' for agriculture would eliminate from the budget 'good money' for productivity, growth and employment.

Neither the Sapir Report nor the Commission makes any substantial allowance for the potential requirements of internal and external security and defence.

The last column of Table 6 presents our budget 'that makes sense'; this should be seen as an indication of how the budget should look like after 2013, rather than as an alternative proposal for the new MYFP.

As may be seen, all spending for agriculture has been eliminated form the budget, and this creates sufficient room to pursue the new tasks to be entrusted to the Union. The main features of our proposed budget are the following:

i) The large increase of spending for research envisaged in the Sapir Report is maintained; the allowance for education is reduced to 2.5%, on ground that this is an area where the Union can play an enhanced 'complementary' role, notably by promoting strong educational standards and much raising student and teachers mobility, but not intervene directly e.g. by establishing educational institutions.

ii) Spending for 'convergence' is raised to 40% of the budget – which leaves room for some continuing support within the old member states – with 10% earmarked for environmental rehabilitation in the new member states; however, no allowance is made for 'restructuring', under the assumption that in the main this task should be left with the member states.

iii) Funds available for external action are reduced somewhat, under the assumption that full access of developing countries' products to EU markets will more than compensate them for the loss of direct financial assistance.

iv) Substantial amounts are allocated to internal and external security and defence, altogether 15.0% of the total budget.

This last change is possibly the most important one. The Union needs substantial resources for internal security, the protection of external borders against international crime and illegal immigration, and military units for peacekeeping and the rapid reaction force.

Common infrastructures will be needed to perform new domestic tasks in the areas of justice, police and immigration. Of course, not all of these new functions will be managed by the Commission and in each case appropriate special arrangements will be required.

What is important is to recognise the need for a step jump in activity by the Union in these fields, and to signal determination to act by making resources available and creating appropriate operational structures. This acceleration of integration and common action will no doubt be fully supported by public opinion, which has been consistently requesting it for a number of years.

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Annex 1. Section on R&D and Lisbon

About five years have elapsed since the Lisbon 'strategy' (or dream?) was officially adopted. The facts are not encouraging. Since 2000, the relative and absolute decline of the performance of the European economy that started in 1995 (but was partially obscured by the 'dotcom' boom of the late 1990s) has continued. In the EU, labour productivity has declined every year and has now reached unprecedented levels. Part of this decline can be explained, but even total factor productivity (the unexplained part) is now close to an historical low.

There is general agreement that, among other factors, a lack of innovation is responsible for this unsatisfactory performance. Some might argue that it is difficult to explain the deterioration of the EU's performance relative to its own past by a lack of innovation since no absolute indicator of R&D or other innovation activity has declined. But the key fact remains that the gap with the US has increased.

In judging the recent performance of the EU, one has to keep in mind that a low intensity of research gradually translates into a low level of accumulated knowledge tomorrow. This effect seems to have worked to increase the distance between the EU and the US over the last decade. Accordingly, using a precise metric for the knowledge capital per worker, Bottazzi (2003) finds that this indicator has more than trebled in the US and Japan from 1972 to 1995, while it rose much less in the EU countries. The proxy for innovative or knowledge capital is the cumulated number of patents (with each patent weighed with the average yearly number of citations a patent posted with the US patent office receives in its first three years of existence). As this trend must have continued over the last decade, the distance between the EU and the US can only have increased.

The Lisbon targets for R&D were confirmed at the Barcelona European Council in March 2002. Furthermore, the latter Council meeting agreed that investment in European R&D must be increased to 3% of GDP by 2010, with at least two-thirds of the total investment coming from the private sector. This target implies a total public sector expenditure of around €100 billion in absolute terms.

At present, R&D amount to 2% of EU GDP, or €200 billion. Increasing this to 3% of GDP would imply an increase of about €100 billion. It is clear that only a small share of this increase could and should come from the EU budget. Even under most optimistic assumption, as embodied in the Commission's proposed financial framework, the funding for the 'European Research Area' would increase by around €8 billion (from €5 billion p.a. today to around €13 billion in 2013), constituting around 8% of the total increase required. (FN: And this assumes zero crowding out of national expenditure.)

While the 'quantity' gap, i.e. the difference in overall spending on R&D between the EU and the US is well known, another, less well known, gap might be more important. This might be called the 'quality gap' and concerns the rate at which R&D spending generates commercially-exploitable ideas. The latter can be measured by patent application. This metric shows that US knowledge workers are almost twice as productive as their EU counterparts, as shown in Table A1.

Table A1. Comparisons in research intensity and productivity

Country	Research intensity (% of workers in R&D)	Research productivity (patents per thousand employees)		
		EPO	USPTO	Average EPO and USPTO
UK	0.32	0.19	0.14	0.16
EU	0.28	0.29	0.17	0.23
US	0.69	0.19	0.63	0.41
Japan	0.65	0.26	0.47	0.37

The relative inefficiency of European R&D must be linked to the segmentation of public research efforts, overlapping of competing research programmes, and thus, underutilisation of available human resources. The 6th Framework Programme constitutes a useful tool to streamline research and promote cross-frontier collaboration and a certain degree of integration of research projects. Nevertheless, the total resources of

the 6th Framework Programme amount to only some 5% of the total public spending on research in the EU and thus can only exert marginal influence on the structure and direction of research.

The quality problem (the low rate of commercially exploitable ideas per worker) cannot be solved by governments alone, and certainly not by the EU alone. But it also certain that more competition in the R&D sector should help to increase its productivity. At present almost all national R&D funding (which constitutes 95% of EU total) is reserved for national applicants (i.e. national universities, research centres, etc.). Opening this sector to EU-wide competition should help to increase concentration and avoid duplication. A world-class European Institute of Technology is more likely to emerge through competition for the best ideas than by EU fiat. The experience with R&D institutions that are financed directly by the budget is also mixed.

A simple calculation can illustrate the cost-effectiveness of market opening versus a larger EU budget for R&D. Opening national (public sector) R&D funding to EU-wide competition could probably increase productivity by 20% or more in this sector, as many studies have shown that in a number of member countries R&D spending is effectively captured by a small group of well-connected insiders. Such a gain on 1% of GDP would be equivalent to an increase in effective R&D equivalent to 0.2% of GDP (or €20 billion), much more than what the EU is spending in this area.

The time has therefore now come to create an integrated EU market for research and for researchers, as already proposed by the Commission a decade ago.

Annex 2. Chronology of budgetary decision-making

Year	Document	EU Financial provisions	Comment
1958	EEC TREATY	Contributions from MS	Annuality of the budget
1965	MERGER TREATY	Merger of ECSC and EURATOM administrative budgets into EEC budget	
1970	LUXEMBOURG EUROPEAN COUNCIL *(Dec. 70/243/CECA,CEE,EURATOM; OJ n.L94, 28/04/1970*)	Introduction of system of own resources (OR): - custom duties & agricultural levies - resource based on a harmonised VAT based; call rate at 1%.	Difficulties with establishing a common VAT system across MS and with the base for VAT assessment, delayed the introduction of VAT as OR until 1979. Enhancement of Community's financial independence from MS' transfers.
1970	LUXEMBOURG TREATY *(Treaty amending certain budgetary provisions*)	- Introduction of a distinction between compulsory and non-compulsory expenditure; - European Parliament given power to adopt the budget.	EP decision excluded for compulsory expenditures Budget discharge to be given by joint Council/ Parliament decision.
1975	BRUSSELS TREATY *(Treaty amending certain financial provisions*)	- Co-decision for adoption of the budget , new allocation of responsibility between Council and Parliament - Budget control entrusted to Court of Auditors	Decision-making powers on budgetary matters shared between the Council and Parliament. The Parliament now gains last word on non-compulsory expenditure; it can reject the budget and acts alone in granting discharge.
			1975-1987 Resource inadequacy and persistent complaints by the UK about its financial contribution. Disputes between budgetary authorities.
1984	FONTAINEBLEAU EUROPEAN COUNCIL (Own resources Decision *No 85/257)*	Temporary solution for budgetary imbalances.	Call rate for the VAT resource rose to 1.4%. Correction mechanism for budgetary imbalances of the UK.
1988	BRUSSELS EUROPEAN COUNCIL. (*Dec.88/376/EEC, on the system of the Communities' Own resources)*	Reform of the Community's financial system (DELORS I)	New resource based on member states' GNP; overall ceiling on OR; capping of VAT resource base at 55% of GNP to reduce regressivity.
1988	BRUSSELS EUROPEAN COUNCIL. (Dec.*88/377 EEC, on budgetary discipline, IIA on budgetary discipline and improvement of the budgetary procedure, on 29 June 1988)*	Reform of the Community's financial system (DELORS I)	Introduction of new budgetary discipline arrangements, binding on all the institutions. The system of MYFP is introduced for 1988-1992 as integral part of Interinstitutional Agreement between Council, Parliament and Commission.
1992	MAASTRICHT TREATY	Establishment of Cohesion Fund	Modest budgetary implications

1992	EDINBURGH AGREEMENT (*Dec.94/728/EEC, on the system of the Communities' Own resource; Dec.94/729 EEC, on budgetary discipline, IIA on budgetary discipline and improvement of the budgetary procedure, on 29 October 1993)*	The DELORS II Package	Increase of the overall ceiling on OR from 1,20% to 1,27%; further decrease of the importance of VAT in the financing of the budget by capping VAT resource at 50% of GNP; Adoption of new MYFP for 1993-1999.
1992-1999			*1992-1999 Significant difficulties during the recession years of early 90s. The OR system into force only in 1995, successive downwards revisions in economic growth during 1992-1994 resulted in downwards revisions to budgetary revenues. Nevertheless, the OR ceiling constraint was respected.*
1999	BERLIN EUROPEAN COUNCIL (*Dec.00/597 /EEC, on the system of the Communities' Own resources; Reg.2040/2000 EC, on budgetary discipline, IIA on budgetary discipline and improvement of the budgetary procedure, on 6 May 1999)*	AGENDA 2000	Gradual decrease of the maximum rate of call for the VAT resource from 1% to 0.75% in 2002 and 0.50% in 2004. The overall ceiling for own resources kept at 1.27%. Adoption of new MYFP for 2000-2006. Ceiling on agriculture (see Excerpt 1 below from document below) until 2006.
2002	Brussels European Council October 2002 (Doc. 14702/02 5)	Enlargement, position by EU-15	Ceiling on agricultural spending for next financial perspective (2007-2013). See Excerpt 2 below.
2002	Copenhagen European Council December 2002 (Doc. 15917/02 12)	Enlargement agreement with new member countries.	Ceiling on agricultural spending for next financial perspective (2007-2013) confirmed with sliding time path. See Excerpt 3 below.
2004	COMMISSION PROPOSAL *(COM(2004)501 on the system of the Communities' Own resources, COM(2004)487 Financial Perspectives 2007-2013, COM(2004)498 on IIA on budgetary discipline and improvement of the budgetary procedure)*	The new FINANCIAL PERSPECTIVES 2007-2013	Own resources ceiling at 1.24% for 2007-2013. Proposal for a generalised mechanism for the correction of budgetary imbalances.

Excerpt 1. Berlin European Council 1999 (current Financial Perspective)

D. Heading 1 (Agriculture)

Agricultural guideline

Overall level of allocations for heading 1

23. In the light of these decisions, the European Council considers that the amounts to be entered in heading 1 of the financial perspective should not exceed:

Heading 1 (Agriculture) (Mio. euros 1999 prices)						
2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
40920	**42800**	**43900**	**43770**	**42760**	**41930**	**41660**
CAP expenditure (excluding rural development and accompanying measures)						
36620	38480	39570	39430	38410	37570	37290
Rural development and accompanying measures						
4300	4320	4330	4340	4350	4360	4370

The Interinstitutional Agreement should include a provision ensuring that all parties to it will respect the financial perspective ceiling for agriculture.

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Excerpt 2. Brussels European Council October 2002 (Doc. 14702/02 5)

Budgetary and financial issues (2004-2006)

10. The ceiling for enlargement-related expenditure set out for the years 2004-2006 by the European Council in Berlin must be respected.

11. The Union's expenditure must continue to respect both the imperative of budgetary discipline and efficient expenditure, and the need to ensure that the enlarged Union has sufficient resources at its disposal to ensure the orderly development of its policies for the benefit of all its citizens.

The phasing-in will take place within a framework of financial stability, where total annual expenditure for market-related expenditure and direct payments in a Union of 25 cannot, in the period 2007-2013, exceed the amount in real terms of the ceiling of category 1.A for the year 2006 agreed in Berlin for the EU-15 and the proposed corresponding expenditure ceiling for the new Member States for the year 2006. The overall expenditure in nominal terms for market-related expenditure and direct payments for each year in the period 2007-2013 shall be kept below this 2006 figure increased by 1% per year.

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Excerpt 3. Copenhagen European Council December 2002 (Doc. 15917/02 12)

ANNEX I
BUDGETARY AND FINANCIAL ISSUES

Based on the accession of 10 new Member States by 1 May 2004, the maximum appropriations for commitments for agriculture, structural operations, internal policies and administration for the new Member States should be the amounts now determined as a result of the negotiations at this European Council, as set out in the following table:

This is without prejudice to the EU 25 ceiling for category 1a for 2007-13 set out in the Decision of the Representatives of the Governments of the Member States, meeting within the Council on 14 November 2002, concerning the conclusions of the European Council meeting in Brussels on 24 and 25 October 2002.

Annex 3. Budgetary provisions in the Constitutional Treaty

1. The yearly budget becomes "European law":

art. I-34, I-56: A European law shall establish the Union's annual budget … The "budget law" shall be adopted, on the basis of proposals from the Commission, by the European Parliament and the Council under the ordinary legislative procedure.

2. The MYFP are brought into the Treaty:

art I-55: The multi-annual financial framework shall ensure that Union expenditure develops in an orderly manner and within the limits of its own resources. MYFP will take the form of an European law of the Council (decided unanimously after obtaining the consent of the European Parliament, given by a majority of its component members.)

art. III-402: The multi-annual financial framework shall be established for a period of at least five years. The financial framework will determine the amounts of the annual ceilings on commitment appropriations by category of expenditure and of the annual ceiling on payment appropriations.

The financial framework shall lay down any other provisions required for the annual budgetary procedure to run smoothly.

3. Application of Community method to budgetary decisions

art III-404 for the yearly budget; also suppression of the category of compulsory expenditures

art. III-396 for the MYFP

4. New procedure for decision on the annual budget

The Commission presents the draft budget to the European Parliament and to the Council.
The Council adopts its position on the draft budget and forwards it to the European Parliament.

If the European Parliament:

(a) approves the position of the Council or does not take a decision, the European law establishing the budget shall be adopted;

(b) adopts amendments by a majority of its component members, the amended draft budget is forwarded to the Council and to the Commission. The President of the European Parliament, in agreement with the President of the Council, shall convene a meeting of the **Conciliation Committee**.

The Conciliation Committee seeks an agreement on a joint text, by a qualified majority of the members of the Council and by a majority of the representatives of the European Parliament.

If the Conciliation Committee agrees on a joint text the European Parliament and the Council shall each have a period of 14 days to approve the joint text.

If:

(a) the European Parliament and the Council both approve the joint text or fail to take a decision, the European law establishing the budget is deemed to be definitively adopted in accordance with the joint text.

(b) the European Parliament, acting by a majority of its component members, and the Council both reject the joint text, or if one of them rejects the joint text while the other one fails to take a decision, a new draft budget shall be submitted by the Commission.

(c) the European Parliament approves the joint text whilst the Council rejects it, the European Parliament may, acting by a majority of its component members and three-fifths of the votes cast, decide to confirm all or some of the amendments.

Where a European Parliament amendment is not confirmed, the position agreed in the Conciliation committee on the budget heading which is the subject of the amendment shall be retained.

The European law establishing the budget shall be deemed to be definitively adopted.

If the Conciliation Committee does not agree on a joint text, a new draft budget shall be submitted by the Commission.

Once the procedure has been completed, the President of the European Parliament shall declare that the European law establishing the budget has been definitively adopted.

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