

COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION

**Treatment of revenue shortfalls in relation to the
own resources ceiling**

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PRESENTATION

As a result of the recession the Community budget, like the Member States' own budgets, is having to contend with shortfalls in revenue: the yield of traditional own resources is lower and the VAT and GNP bases are smaller. Initially these shortfalls will affect cash resources. So that the expenditure voted and actually incurred in the year concerned can be covered thereby respecting the principle of budget equilibrium, the shortfalls must then be entered as expenditure in the budget for the next year or the next year but one.

For 1992 the shortfalls could be as much as ECU 2 billion, and perhaps double that in 1993. The financial regulations require these amounts to be budgetized in 1993, 1994 and 1995.

For the first time since 1988, all the own resources available beneath the ceiling will have to be entered in the initial budget for 1994, and very probably in the one for 1995 too. As there are no explicit rules about how the own resources ceiling should be applied in this case, the entry by a SAB of past years' revenue shortfalls as expenditure might be set off against the own resources ceiling and considered to imply an equivalent reduction in the expenditure adopted for the year in question.

It would be something of a paradox if accounting adjustments relating to revenue forecasts for past budgets, which had been adopted and implemented within the limit set by the own resources ceiling, should affect the implementation of the budget for a later year. If there were no agreement on budgetization arrangements, the Commission's cash resources would be gradually exhausted.

To pre-empt this danger the Commission proposed in preliminary draft supplementary and amending budget No 1/93 that the margin still available in 1993 beneath the own resources ceiling be used to budgetize in advance the revenue shortfalls which can already be identified for 1992 and 1993. This is no more than a temporary, makeshift solution which will not cover all the expected shortfalls. It will also mean that the Member States have to make the corresponding payments to the Community budget ahead of the schedule laid down in the financial regulations and thus to make drawings on their cash resources that had not been programmed.

A comprehensive and permanent solution would be much more satisfactory. Present circumstances have revealed a new problem in the application of the own resources ceiling and the way this links up with budget balances. It is the Commission's responsibility to devise and propose rules which could be applied in such cases to guarantee smooth operation of the budgetary procedure.

It is therefore suggested that the following three rules be incorporated in the secondary legislation implementing the own resources Decision (Regulation No 1552/89):

- for the application of the own resources ceiling, no account is taken of any negative balance from the previous year that is to be charged to expenditure in the budget for the year in question;
- a positive balance, to be entered as revenue in the budget for the year in question is set off against the own resources ceiling;
- if, however, in the course of the year, actual expenditure, net of miscellaneous revenue, is found to have exceeded the actual ceiling for own resources, the excess is deducted from the estimate of the own resources ceiling in a subsequent year.

This amounts to agreeing that, provided the own resources ceiling has been respected, any revenue shortfalls or surpluses generated by the economic situation will have no effect on the way in which the own resources ceiling is applied.

These rules will ensure compliance, at both the authorization and the implementation stages, with the two principles of budget equilibrium and of the annual limit on the own resources assigned to the Community. They ensure that revenue surpluses and shortfalls are treated symmetrically. They do not entail any change in the way in which balances are entered in the accounts and in the budget, hence the normal schedule for the relevant movements of funds with Member States is not affected. In particular Member States will not have to make any payments in a given year in excess of what is required to cover expenditure which is voted and actually incurred.

The Commission will later make a formal proposal for amendment of Regulation No 1552/89 on the application of the own resources system.

I. The present situation

Since 1991 the Community's economy has been hit by falling demand in most of the Member States, producing shortfalls in tax revenues and widening government deficits.

The economic situation is also affecting the Community budget: traditional own resource revenues (from agricultural levies and customs duties) are falling and the Community has had to refund (with call-in rates remaining unchanged) the excess amounts paid by the Member States as a result of over-optimistic forecasts of the VAT and GNP bases. The economic slowdown has been sharper and more prolonged than expected, leading to significant differences between forecast and actual receipts.

While underestimates of economic growth in 1988 and 1989 resulted in considerable budget surpluses from 1989 to 1991, economic trends in 1992 and 1993 are now producing the reverse phenomenon.

To compensate for the own resources shortfall, an extra ECU 3 200 million may have to be charged to the 1994 budget and more than ECU 2 000 million to the 1995 budget, unless they can be partly budgeted for in advance.

Charges of this size would seriously disrupt implementation of the 1994 and 1995 budgets, and would even call into question the conclusions of the Edinburgh European Council on the future financing of the Community. The own resources ceilings, expressed as a percentage of GNP, were set high enough to meet the Community's annual operating expenditure from year to year under the financial perspective. Medium-term objectives would be jeopardized if large negative balances in respect of previous years were covered at the expense of large reductions in budget resources for future years.

II. Normal use of financing possibilities under the own resources ceiling

The ecu equivalent of the own resources ceiling for a given year (n) is calculated (at the prevailing rate) in February of the preceding year (n-1) when the preliminary draft budget is drawn up, and is based on the most recent forecast of Community GNP for the year in question (n) (economic forecasts).

Revenue from own resources entered first in the preliminary draft budget and then in the budget must be high enough to cover all payment appropriations on the expenditure side. No provision is made for possible shortfalls or surpluses, either for the year in question or for previous years.

The total amount of payment appropriations in the budget must not exceed the ceiling in the financial perspective, which, apart from a margin for unforeseen expenditure, is the same as

the own resources ceiling. The margin can be used to raise the ceiling retrospectively in order to finance additional expenditure under the appropriate category, or to cushion the impact of unexpectedly sluggish growth. It is not intended for financing negative balances from previous years.

III. Treatment of shortfalls and surpluses in the budget and the accounts

The amount of traditional own resources (levies and customs duties) paid by the Member States depends on the amount collected from operators in the course of the year (n). A difference between this amount and the total amount entered in the final budget gives rise to either a positive or a negative balance, which is then incorporated into the budget by means of an amending budget the following year (n + 1).

The amount of VAT and GNP own resources to be paid is calculated by applying the call-in rate for the year in question (n) to the projected collection bases. The calculations of the bases are revised during the following year (n + 1) and corrections are made retrospectively - and as soon as they are known - to the amounts paid by the Member States. These corrections give rise to another, secondary balance (positive or negative), which is also entered in the budget by means of an amending budget the next year (n + 2).

During each budget year, the overall balance from the previous year must be corrected by means of amending budgets. This balance is the sum of three different elements:

- the traditional own resources surplus or deficit from the previous year (n - 1);
- the VAT and GNP own resources surplus or deficit from two years earlier (n - 2); and
- payment appropriations from the previous year (n - 1) which have lapsed.

If the overall balance is positive, it is accounted for as revenue; and if negative, as expenditure.

IV. Special circumstances

The current slowdown in the economy has been particularly sharp. The 1992 and 1993 budgets were based on the assumption that GNP would grow by 2.5% in 1992 and 1.4% in 1993. The economic forecasts for February 1993 put growth at only 1.0% and 0.6% for those two years. Since then the outlook has further deteriorated. The financial perspective adopted at Edinburgh assumed real economic growth of 2.2% in 1994. This forecast was revised downwards to 1.8% in February, when the technical adjustment was made prior to preparation of the SAB.

Furthermore, as a result of the currency fluctuations, exchange rates have changed since the 1993 VAT and GNP bases were

converted into ecus. Consequently, the bases have shrunk by approximately 2.4%. Thus both monetary and economic factors are reflected in the corrections to the VAT and GNP-based resources, producing an even larger negative balance.

In 1992, the shortfall in traditional own resources amounted to around ECU 650 million, which will have to be included in the 1993 budget. The amount to be refunded to the Member States because of the over-optimistic forecasts of the VAT and GNP bases could attain ECU 1 200 million, and should normally be included in the 1994 budget.

The shortfall in traditional own resources for 1993 may exceed ECU 2 000 million, which would have to be charged to the 1994 budget. As regards VAT and GNP resources, Member States will additionally have over-contributed by more than ECU 2 000 million (ECU 1 200 million on account of currency fluctuations and not less than ECU 850 million because of the recession). This will have to be charged to the 1995 budget.

As a result of current economic trends, the total amount of payment appropriations in the financial perspective agreed upon at Edinburgh is set to reach 1.20% of GNP, the own resources ceiling, in 1994. The ceiling will probably be reached again in 1995, despite the planned increase to 1.21%. Even if the economy picks up and real growth averages 2.5% per annum from 1995 onwards, which is the scenario on which the financial perspective is based, the 0.01% margin for unforeseen expenditure is, for virtually all the foreseeable future, already accounted for.

Furthermore, increased agri-monetary costs will entail a significant reduction in the amount of unused payment appropriations over the coming years, which might otherwise have helped to compensate for the own resources shortfall.

To summarize, a number of factors are combining to produce an unprecedented budget deficit for the Community. Therefore, it has become necessary to propose solutions concerning the accounting and budgetary treatment of the effects of economic recession on the own resources base, and on the assessment and payment of those resources.

V. Possible solutions

Ruling out the dubious and politically dangerous option of simply setting the shortfalls against operating appropriations in the coming years, there are two possible solutions:

1. Advance inclusion in the 1993 budget of shortfalls in own resources

(a) Under the 1993 budget, payment appropriations are some ECU 3 000 million below the ceiling fixed in the financial perspective agreed at Edinburgh. No further margin is available between this ceiling and the own resources ceiling.

The Commission has presented PDSAB No 1/93 as modified by letter of amendmen No 1 in which it proposes to take into account not only supplementary expenditure under the EAGGF Guarantee Section and the European Investment Fund but also the following own resources items:

- the estimated balance for 1992 (this is standard practice), including a shortfall in traditional own resources of around ECU 650 million;
- part of the shortfalls in VAT and GNP own resources (which would normally be included in the 1994 budget) arising from downward revisions in the corresponding bases for 1992 and amounting to an estimated ECU 1 165 million;
- the adjustment of the 1993 VAT and GNP bases (ahead of the 1995 budget) following exchange rate changes since the bases were determined in February 1992 - a total of ECU 1 200 million.

It proposes furthermore to take into account some of the shortfall in traditional own resources, estimated to be around ECU 2 000 million, by means of a corresponding increase in the call-up rate of the fourth resource.

The advance inclusion in the budget of corrections to own resources does not conflict with the Financial Regulation, Article 32 of which implies that estimates of balances should be entered at an early date.

(b) The last factor to allow for is the effect of the likely shortfalls in VAT and GNP own resources in 1993 - ECU 850 million on the basis of the February economic forecasts and probably more, given the current economic outlook. These shortfalls should be included in the 1995 budget.

This solution would only present a temporary and partly response to the impact of shortfalls on the budget. It would not cover procedures for dealing with the connection between such balances and the own resources ceiling.

2. Treatment of balances in own resources regulations

The procedures for dealing with subsequent corrections to own resources and the corresponding balances, both at budgetary and accounting level, are laid down in the current regulations.¹ However, the connection between these balances and the own resources ceiling applicable in a given year is not mentioned explicitly. We now have the opportunity to clarify the rules.

(a) The budgetary equilibrium principle and the balances mechanism

The Community budget is founded on strict respect for the equilibrium principle, at the authorization stage and in implementation. The amount of own resources called in each year should be equal to expenditure (payment appropriations) for that year, net of other revenue.

The procedures for the budgetary and accounting treatment of balances are designed to ensure that the equilibrium existing at the authorization stage is maintained in the outturn. For VAT and GNP resources in a given year n , this requires a two-stage adjustment:

- shortfalls (or surpluses) at the initial call-in rate give rise to refunds (or additional calls) during year $n + 1$;
- these refunds (or additional calls) are included, other things being equal, in the negative (or positive) balance for the same year ($n + 1$). This balance is then budgetized the following year ($n + 2$).

Taken as a whole, and leaving aside shortfalls/surpluses in traditional own resources or any unused appropriations for the year, the amount of VAT and GNP own resources actually made available for year n remains, as far as all Member States are concerned, equal to the amount authorized in the budget for that year.

A positive balance is entered under revenue and a negative balance charged to expenditure. Provided there is no ceiling for own resources, such treatment in no way ties the hands of the budgetary authority as to the use of the balances:

¹ - Article 7 of Decision 88/376 on the system of the Communities' own resources
- Article 15 of Regulation No 1552/89 implementing Decision 88/376
- Article 32 of the Financial Regulation.

- a positive balance may be used, other things being equal, to finance additional expenditure or to reduce the call for own resources during the year in which the balance is entered in the budget;
- a negative balance may be offset by reducing expenditure in the same year or it may be financed by a call for more own resources.

(b) Connection with the own resources ceiling

If there is a ceiling for own resources, on the other hand, it is necessary to specify how balances from previous years are to be treated in relation to the own resources ceiling for the year in which these balances are entered in the budget.

Such treatment needs to:

- be symmetrical, according to whether the balances are positive or negative;
- reconcile the logic underlying the balances mechanism (a balanced budget outturn) and that underlying the own resources ceiling (a fixed annual upper limit for the amount of own resources made available to the Community).

It would be paradoxical for the financing capacity provided by the ceiling in a given year to be reduced as a result of corrections to the estimates of resources in previous years, after the budget for these years had been adopted and implemented within the own resources ceiling.

Conversely, under-utilization of the own resources ceiling during a given year (at the authorization or implementation stage) should not automatically mean that the annual ceiling can be exceeded by an equivalent amount in subsequent years (non-accumulation of ceilings over the period).

In other words:

- negative components of the balances for previous years ought to be able to be financed, during the year in which they are budgetized, over and above the own resources ceiling for that year;
- the positive components of the balances from previous years should not be used to allow the own resources ceiling to be exceeded during the year in which they are budgetized.

Thus, when applying the own resources ceiling to a given year, the balances from previous years would effectively be neutralized - whether entered as revenue (positive balances) or charged to expenditure (negative balances).

If balances were to be neutralized vis-à-vis the own resources ceiling, there would be a logical obligation to respect the ceiling each year at both the authorization and implementation stages. It would need to be pointed out that exceeding the ceiling in the course of the year would be compensated for by a corresponding reduction in the ceiling available the following year. In practice, testing to see whether the own resources ceiling in year n had been respected could be done in year n + 1 when the VAT and GNP bases were reassessed. If the ceiling were found to have been exceeded, then the own resources ceiling in year n + 2 would be lowered accordingly.

(c) **New provision for introduction into the own resources regulations**

The proposed treatment does not involve any change to:

- the system of own resources and the methods of establishing them;
- the budgetary and accounting rules governing the calculation and recording of budgetary balances.

The sole aim is to clarify the rules for implementing the own resources ceiling since they are not made explicit in the current regulations.

It would be logical for such a provision to be inserted in the relevant secondary legislation.

Council Regulation (EEC, Euratom) No 1552/89 of 29 May 1989 implementing Decision 88/376/EEC, Euratom could be altered to include a new Title "Va - Rules for the application of Article 3(1) of Decision 88/376/EEC, Euratom".

This provision might read as follows:

"For the purposes of applying the annual ceiling on own resources, no account shall be taken of any negative balance arising in the previous year and charged as expenditure in the budget for the year in question. Similarly, a positive balance arising from the previous year, and entered as revenue in the budget for the year in question, shall be set off against the own resources ceiling.

In the year following the implementation of the budget in a given year n, the own resources ceiling shall be compared with the amount of actual expenditure in terms of payment appropriations. Such expenditure shall not include negative balances arising from previous years and entered in the budget or miscellaneous revenue or any other resources actually received during the same year. If the resulting expenditure figure exceeds the own resources ceiling then the excess shall be used to lower the ceiling for own resources available in year n + 2".

If the implementing regulation were revised along these lines and adopted, the provision could come into force in time for 1994.

VI. Conclusions

Since differences between forecast own resources and actual outturn are unavoidable, budgetary amendments have, under the existing rules, to be made in subsequent years. Although the negative balances correspond, at least partially, to the refunds to Member States, they affect the funds available for the following year - a problem if there are not enough cancelled appropriations or if there is no margin left below the own resources ceiling. This is a scenario that will be encountered during the period 1993 to 1999.

In order not to constrain the use made of own resources in financing the Community policies the treatment in relation to the annual own resources ceiling of positive or negative balances arising from the previous year will need to be clarified. This could be inserted in the Regulation (No 1552/89) implementing the own resources Decision.

INCLUSION OF SHORTFALLS IN THE BUDGET

	1992	1993	1994	1995
	(mio ECU)			
<u>Inclusion of shortfalls from 1991</u>				
• TOR	-282			
• VAT/GNP		72		
<u>Inclusion of shortfalls from 1992</u>				
• TOR		-650		
• VAT/GNP			-1 200	
<u>Inclusion of shortfalls from 1993</u>				
• TOR			-2 000	
• VAT/GNP				-2 050