Center for EU Enlargement Studies

MAGYAR KÖZGAZDASÁGI TÁRSASÁG

*Preparing for the EU Council Presidencies of the Visegrad Countries*

# The new EU Budget and the new Member States

Edited by Tamás Szemlér

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## Preparing for the EU Council Presidencies of the Visegrad Countries

*“EU Council presidencies provide a unique opportunity for shaping the European agenda. The objective of the project is to help facilitate the work of Visegrad countries in assuming their responsibilities under their respective EU Council Presidencies and to contribute to the coordination of their agendas in order to achieve joint objectives. It aims to add a V4 angle to the presidencies of the individual countries and thereby contribute to the visibility and success of V4 cooperation”.*

The project is generously supported by the International Visegrad Fund

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# The EU budget – Before a New Chapter of an Evergreen Story

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The European Union (EU) is one of the most debated issues of European integration. Debates between member states caused an almost continuous conflict situation for the second half of the 1980s. From 1988 on, with the creation of the multiannual financial frameworks, the fundamental debates have become less frequent: the framework being decided for a mid-term period (actually, for seven years), the regular yearly budgetary process has become more technical, as the strategic issues have been decided at the debates around the financial framework.

This, however, does not mean at all that there would be less conflicts and unsolved issues around the EU budget. In fact, old budgetary conflicts have remained important. Among the causes of these conflicts, debates about the Common Agricultural Policy (CAP), about the EU's structural and cohesion policy and about the net position (vis-à-vis the EU budget) of the individual member states are the most well-known ones.

In addition to the old conflicts, new ones appeared – or, in some cases, the old conflicts have become more intense due to certain developments of the integration process. This is true both for the widening and the deepening of the integration. In 2004 and 2007, the eastern enlargement of the EU has changed the overall picture of the EU a lot: differences between the most and the least developed territories of the EU have considerably increased, and the relative position of the earlier less well-to-do member states has changed, as well (due to the statistical effect of enlargement with considerably poorer countries). With regard to deepening, new challenges occurred; a part of them (such as e.g. the need for responses to the threat of the climate change, more need for innovation and R&D) are considered seriously by the EU; however, due to the status quo based position of the member states, corresponding adjustments are very difficult to realise in the EU budget.

This situation has become very clear during the negotiations about the present – 2007-2013 – financial perspective. Early 2004, the European Commission initiated the debate with a proposal containing some (even if quite moderate but real) reform options with regard both to the financing (new own resources, solution of the problems caused by the UK rebate) and to the expenditure (new headings, new weights and structure) items of the EU budget. While some of the proposals on the expenditure side have been realised after the almost two-year long bargaining (even if part of them seems to be barely more than optical tuning), the most crucial debates have only been solved technically: compromises, but no long term solution for the old debates have been found.

The agreement reached in December 2005 foresaw a review of the EU Budget; the review has been planned as an exercise independent from any political commitment and therefore open for any ideas. The review had begun with the consultation paper published by the European Commission in September 2007, and continued with an EU-wide public consultation until mid-2008. The European Commission was originally supposed to deliver a paper with the conclusions of the review late 2008-early 2009, but this has not happened until now. More urgent developments of the EU, long-term strategic ones (the solution of the debates around the Lisbon treaty) as well as the normal issues of actuality (EP elections, the nomination of the new Commission) have pushed the debate (which could be interesting, but had no serious political impact anyway) to the background. As for now the Lisbon Treaty is saved, the institutions are reelected/renominated, there is a chance to deal with the EU budget again.

Of course, due to the world financial and economic crisis, the situation is different from the one before; however, conflict sources have remained, but additional tension is felt. There is also a time pressure on those who intend to come up with new (or old, but newly formulated) ideas: when one looks at the timetable of the previous negotiations of the financial perspectives, it is quite probable that the debate on the next financial perspective (beginning in 2014) will begin seriously early 2011. As things look now, that debate – already with high stakes for all member states – will begin in a situation that the budget review has not produced a breakthrough.

Considering all the above processes and factors, it is high time to observe member states' positions. The CEU ENS has therefore organised an expert debate in order to get an overview of the positions of the Visegrád countries as well as to discuss an overall reform proposal of the financing of the EU budget. The contributions to this booklet are the written versions of the authors' presentations.

Each contribution examines the prospects of the EU budget from a specific (with one exception, country-specific) point of view. Still, some common features can be identified. One of them is that no author foresees a potential breakthrough in the own resources system – ideas exist (a comprehensive one is presented in the only not country-specific contribution of this booklet), but member states are reluctant to transfer further parts of sovereignty to the EU in this area.

On the other hand, all country papers support the feeling that there are good chances for considerable change on the expenditure side. First of all, the reform of the CAP seems to be very likely – of course, there are different depths of and options for further reform. Structural and cohesion policy, a key instrument for the so much longed catching-up process of the new members is likely to change, but it is also probable to maintain (at least) its importance in the EU budget. Competitiveness seems to be a priority for everyone – no doubt that the world financial and economic crisis even strengthened the arguments in this direction.

Of course, ideas alone are not enough. The budget should provide the necessary resources to realise them. However, budget size will probably be again the practical limit: while the net beneficiaries – among them the Visegrád countries – are interested in a bigger budget, the net contributors want to keep the volume of the budget as low as possible. Therefore there is a considerable risk that during the debates on the next financial perspective, the *juste retour* approach will overcome again, meaning that net positions will be again in the centre of bargaining.

# The EU budget after the global financial crisis[1]

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## What has changed compared to the pre-crisis situation?

The 2008/2009 review of the EU budget became practically invisible in the shadow of the global financial and economic crisis. Any remaining room for publicity had been occupied by the calamities concerning the ratification of the Lisbon Treaty. In early 2010 the Lisbon Treaty poses no problem any longer, the recession in the EU seems to be finished, attention is focused on the exit strategies. But the world, and more specifically the EU, is not the same place as it was in the summer of 2008.

The period of ample liquidity, limited risk awareness, high current account deficits, easily available external financing is over, with the very probably consequence of lower GDP growth rates both in the old and the new member states compared to the pre-crisis period. The new member states (NMS) will not only be hit by the less favourable international financing but by the lower import demand of the old member states (OMS) originating in their lower GDP growth rates. The discussion on the cross member state redistribution will have to be resumed in a generally less dynamic economic environment.

Anti-cyclical economic policy measures and desperate efforts to prevent the collapse of the financial intermediation necessitated major government expenditures from October 2008 on. General government deficit of the EU 27 amounted to 0.8 of the GDP % in 2007, 2.3% in 2008, likely around 7% in 2009.[2] The Commission's forecast is 7.5% in 2010 and 6.9% for 2011.[3] Four member states (all of them old member states!) will have a budget deficit surpassing 10% of their GDP both in 2009 and 2010. Although non of the four major net payer countries (Netherlands, Germany, Sweden and Austria) belongs to the group of member states with the highest (over 10%) GDP proportional budget deficit, the fiscal balance has seriously deteriorated in each of them compared top the pre-crisis situation. The compliance with the requirements of the Stability and Growth Pact will be a difficult task for each of them except for Sweden. Other key players in the

[1] This text is the draft of a contribution to the panel discussion at the CEU Workshop "The new EU Budget and the new member states" at the CEU, January 21, 2010. Please do not cite this text without contacting first the author (richter@wiiw.ac.at).
[2] European Economic Forecast, Autumn 2009, p. 206. (European Commission)
[3] Op. cit.

forthcoming bargain on the budget France and even more the UK also are hardly hit by the crisis and have very high budget deficits.

If we recall the dishonourable fight over individual items, exceptions, the UK rebate, the CAP's future that occurred in a substantially favourable economic environment in December 2005[4], what can we reckon with in the negotiations in 2011? Without doubt, positions of potential net payers of the next financial perspective will be much more rigid and egoistic than they were in 2005. Contrary to 2005, when no real constraints were present for a relaxed net payer attitude, in 2011 the countries concerned will still cope with their increasing debt and the necessities of budget consolidation.

The crisis hit the NMS substantially harder than the most of the OMS. These countries had typically much higher GDP growth rates than the OMS before the crisis and steeper recessionary declines from October 2008. Deliberate anti-cyclical economic policy measures in the form of additional government expenditures were made in two NMS only, Bulgaria and Slovenia. In the latter the scope of these measures may have amounted to 2 % of the GDP. In the other NMS the state was rather restrained. The significance of transfers from the EU budget under the given circumstances gained on importance, although their real weight is far from being acknowledged. While public investment and government consumption in best case stagnates, in practice declines, increasing (over 2007-2013) EU transfers provide an important contribution to domestic demand. In Hungary the net inflow from the EU budget is estimated to reach 1.9% of the GDP in 2010, up from 0.7% in 2007, 1% in 2008 and 1.7% in 2009.[5] The figures must be of the same magnitude in the Czech Republic, Poland and Slovakia, smaller in Slovenia (higher level of development, smaller transfers) and in Romania and Bulgaria (phasing in is not completed). This resource jumps in as a substitute for non existing anti-cyclical fiscal policies and thus it is of invaluable significance.

Summarising, slower growth will reduce readiness of net payer countries to contribute to cross member state redistribution. Reconstruction of a sustainable fiscal stance will require several years in a couple of net payer MS, making any net contribution to the community budget a hot issue in the domestic political arena. Anti-EU populism have now the right stuff to launch frontal attack against redistribution. In the EU level bargaining harder domestic struggles will appear as more rigid positions along the old axes of discussions e.g. CAP - UK rebate. The usual patterns of negotiations with enforced compromises in the last minute threaten with a collapse of the negotiations.

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[4] At the European Council 15/16 December 2005.

[5] Hungary: Fourth Review Under the Stand-by Arrangement, and Request for Modification of Performance Criteria. IMF Country Report No. 09/330 December 2009. p. 26.

*Perhaps this is the magic moment for a radical reform!*

Outline of a radical reform of the cross member state redistribution in the European Union[6]

The main idea behind the proposed reform is that the member states' open or disguised endeavour to achieve 'juste retour' is a fact that cannot be ignored. The way to a lasting solution implies the acknowledgement that this endeavour exists and ultimately governs member state attitudes. The reforms which have a chance for success are those which sufficiently satisfy member states demands.

The *guiding principles* of the proposed new EU budgetary system are:

- fair sharing of burdens between member states, citizens and firms;
- clear and simple rules for the collection of revenues and the allocation of expenditures, without exemptions.

*New rules of cross-member state redistribution*

One of the two cornerstones of the proposed system is the EU-27 average per capita GNI, at market/official exchange rates.[7] Each member state would annually receive a transfer from the EU budget that corresponds to 1% of the *EU average per capita* GNI multiplied by the number of inhabitants in the member state concerned. The revenues of the EU budget would be secured through contributions from the member states, which would amount to 1% of the *member state* GNI, the second cornerstone of the reform. Member states whose average per capita GNI is higher than average would thus be net payers, those whose average per capita GNI is lower would be net beneficiaries. Net contributions and receipts, respectively, would clearly reflect the differences in relative prosperity between the member states.

The proposal is illustrated by a practical example for 2006. 1% of the EU-25 per capita GNI in 2006 amounted to EUR 245. Finland, with its about 5.3 million inhabitants, would have received from the EU budget EUR 1,293 million. 1% of Finland's per capita GNI amounted to EUR 320; thus the country's contribution to the EU budget would have been EUR 320 times

[6] This concept was first outlined in Richter, S.: Facing the Monster 'Juste Retour' On the Net Financial Position of Member States vis-à-vis the EU Budget and a Proposal for Reform. wiiw Research Report No. 348, Vienna May 2008. An updated version of the proposal was published as EU CONSENT EU Budget Working paper No. 7. August 2008 under *www.eu-consent.net*. This contribution to the panel discussion relies to a large extent on the second mention publication.

7 A similar solution for allocating the expenditures of the EU budget was put forward in a proposal based on GDP of individual member states multiplied by a coefficient in Quaisser, Wolfgang and John Hall (2002), 'Toward Agenda 2007: Preparing the EU for Eastern Enlargement', Working Papers, No. 240, Osteuropa-Institut München, February 2002.

the number of inhabitants, EUR 1,686 million. The Finnish *per capita* net financial position would have been EUR -75, that of Finland EUR -394 million. Taking a net beneficiary member state with a per capita GNI below the average of the EU as an example, Latvia would have received from the EU budget the same amount as Finland, EUR 245 for *each* of its about 2.3 million inhabitants, in total EUR 561 million. Latvia's contribution in that year would have been 1% of its GNI, EUR 157 million (EUR 69 per capita), which would have led to a positive net financial position ('surplus' vis-à-vis the EU budget) of EUR 404 million, i.e. EUR 177 for each inhabitant in Latvia.

The 1% key applied in the proposal is chosen arbitrarily, but its feasibility is proven by the funds allocated in the 2007-2013 financial perspectives. This key can be higher or lower than 1%, but it is important that it be a *unified* rate both across member states on the revenue side and for the aggregate GNI of the EU on the expenditure side of the EU budget.

*Revenues of the EU budget*

The *value of member states' contributions* would be exactly defined through the above rules. Contrary to the current system, contributions would be collected from the *citizens* and *firms* in each member state. A pre-fixed share, half or two thirds, of the required sum would come from re-channeling a part of the *VAT tax revenues*, the other half or one third from a part of *corporate income tax* revenues, both collected by the *national authorities* in each member state. There would be *no direct EU tax,* revenues from two existing taxes would be split up between domestic and EU destinations. To make this understandable to EU citizens, all invoices with VAT rates would have to display the *national* and the *EU* tax rates separately. A similar solution would have to be found for the split between the EU versus the national share in the corporate income tax revenues as well. This solution would combine the accuracy of national account calculation (fixing contributions at 1% of GNI) with the request to leave the national treasuries out of the game.[8] Simultaneously, it would raise the sensibility of EU citizens through direct and visible participation in EU budgetary processes. Furthermore, a partial re-channeling of corporate taxes of the EU budget would fulfill the justified request that those who benefit the most from the unified European market (the business sector) should contribute directly to the maintenance of the system. It is important to find the appropriate tax rates which guarantee that the revenues channeled to the EU budget are sufficient in any year to cover the pre-fixed

8 This solution is similar to Iain Begg's proposition to cap the gross contributions by member states and allow each member state the free choice to select the sort of European tax which is thought to be the most suitable for the member state concerned. Begg, Iain, 'The 2008/9 EU budget review', EU-Consent EU-Budget Working Paper No. 3, March, 2007 p. 17. See at www.eu-consent.net.

sum of member states’ contributions. The part of revenues earmarked for the EU which surpass the pre-fixed sum of member states’ contribution would be *re-channeled* to the member state treasury.

*Expenditures of the EU budget*

In the new system, the sum of expenditures for individual member states would be fixed *ex ante*. For each member state, transfers from the EU budget as calculated above should be made available solely for financing eligible expenditures within the framework of EU policies, i.e. these transfers must not be disbursed for any other purposes than those agreed upon by the member states. That means that member states would dispose of a ‘basket’ whose internal proportions could be determined in optional ways. The new system would allow for both the allocation of expenditures according to uniform proportions in a highly centralized way directly from Brussels and for a greater extent of flexibility with member states’ individual patterns of allocation across eligible spending targets. The author of this paper thinks that increased flexibility, compared to the current situation, in the allocation of EU expenditures across EU policies/targets in individual member states would be an important asset of the reform. The remaining question is, however, what extent of freedom should be given to national governments. Without doubt, the changeover to the new system would open discussions about the rationale of cross member state redistribution in the EU. Yet, in the current system discussions about and member states’ attitudes on the various EU policies financed from the Community budget are strongly biased by the unspoken deliberations concerning the member state net financial positions. As these considerations necessarily vanish in the new system, a new chapter could be opened in the discussion on terms such as the European value added, subsidiarity. A complete reconsideration of agricultural support, structural policies and expenditures to enhance competitiveness would become possible.

*Net payer member states: better net financial positions after the reform*

Table 1 displays the real net financial positions of the net payers in 2006 and the estimated net financial positions if the reform would have already been in place in that year, further the estimated 2013 net financial positions both under the current and the reformed regime, respectively. The 2013 figures show that the net financial positions of all but two net payer member states are better in the reformed than in the current regime. This is especially the case if we take into consideration that the effect of the UK rebate is not included in the estimation of the current regime, i.e. in real life the improvement would be somewhat larger than in this estimation because the basis for comparison would be smaller (certainly not for the UK). The assessment of the UK position is not easy. However, if we take into account the rebate which the UK will still enjoy, be it to a reduced extent, we can make the cautious assumption that the UK’s relative position in the reformed system would remain unchanged in 2013 compared to that assumed to evolve under the current regime.

*Net beneficiary member states: smaller but secured net gains*

Compared to the estimated net financial positions in 2013 under the old regime the new member states would suffer considerable losses under the reformed system (see Table 2). The most important losers would be Hungary, Lithuania and Estonia (from 2.3 to 1.9 percentage points relative to the GDP), but for different reasons: Hungary because of the high basis in the comparison due to an exceptionally good combination of eligibilities both under the current CAP and cohesion policy, Lithuania due to the high basis and rapid catch up, and Estonia mainly due to its exceptionally rapid economic growth. (These calculations reflect growth scenarios set up still before the global financial and economic crisis which drastically redrawn the growth outlook in both Baltic states). Smaller but yet considerable losers (around 1.5 percentage points) are the Czech Republic, Latvia and Slovakia. Another group of net beneficiary member states would lose 1 percentage point or less: Poland, Greece, Portugal, Malta and Slovenia. Spain and Cyprus would gain from the changeover. Does it mean that these member states would oppose the reform?

Not necessarily. The prevailing rules will not change until 2013. It is extremely important to point out that all the exercises for assessing the net financial positions in the year 2013 clearly bear a message for the period *after* 2013. Clear rules for the post-2013 years, smaller, but secured and foreseeable transfers from the EU budget in the long term, further significantly increased flexibility in using EU resources may win the net beneficiary member states for the reforms proposed. Last but not least, it is almost impossible to argue against the proposed system on the basis of a fair sharing of burdens and gains.

*Further enlargements affordable in the reformed system*

The proposed system was tested for the impact of the EU accession of six West Balkan countries (Albania, Croatia, Bosnia- Herzegovina, Macedonia, Montenegro and Serbia), then the accession of Turkey. The results suggest that the impact of the West Balkan enlargement by six countries in 2013 would be relatively small, the accession of Turkey would bring about a larger rearrangement of financial positions (see Table 3 and 4). In the EU-34 with the West Balkans and Turkey, the average GNI would be EUR 242 only, EUR 35 less than in the EU-27.

The net redistribution (the sum of net payers' contributions to the EU budget less the transfers these member states receive, what is equal to the sum that net beneficiary member states receive in transfers, minus what they contribute to the EU budget) would increase from 0.16% (EU 27) to 0.23% (EU 34) of the EU GNI. While the change might seem significant compared to the EU-27, it is interesting to compare this rate of net redistribution with the respective figure, 0.22% of the EU GNI in 1997, when the EU had only 15 members and cross member state differences in relative prosperity were much smaller than in an EU-34 with Turkey.

## Conclusions

Under the current regulations, a group of highly developed member states has been contributing to the EU budget to a substantially larger extent than the rest of the highly developed member states. Special, non-rule-based regulations (UK rebate, rebate on the financing of the UK rebate, number of exemptions agreed upon at the December 2005 summit) have been necessary to avoid the collapse of cross member states redistribution in the EU. Although the next round of negotiations on the post 2013 financial framework is still far away, there is no way to avoid extreme net financial positions without exemptions under the current system, and the whole bargaining process cannot be based on another principle than that of fighting for a juste retour.

The chief attraction of the proposed new system is that it addresses the juste retour problem directly instead of negating or circumventing it. After the introduction of the reform, simply no room would remain for the juste retour attitude. Contributions to the EU budget would reflect the relative economic strengths of the member states. The popularity of the European integration may increase due to the fact that per capita expenditures are equally high for each EU citizen; at the member state level expenditures would only be the function of the size of the member state population. The net financial positions would reflect the levels of development of the individual member states relative to the EU average. Thus, there would be no need for exemptions or any other non-rule-based regulation. The increased flexibility in allocation of EU co financed expenditures in member states would neutralize ‘juste retour motivated’ discussions on the current and future importance of individual EU policies, as there will be no linkages between the net financial positions of member states and their more or less intense involvement in certain EU policies.

**Table 1**

Net payer member states: comparison of real and estimated net financial positions in 2006 and 2013, in % of GNI

| Member state | Current regime 2006 (fact) | New regime 2006 | Difference 2006 new/current | Current regime 2013* | New regime 2013 | Difference 2013 new/current |
|---|---|---|---|---|---|---|
| | | | deviation in % points | | | deviation in % points |
| | (1) | (2) | (2)-(1) | (1) | (2) | (2)-(1) |
| Netherlands | -0.47 | -0.27 | 0.20 | -0.53 | -0.25 | 0.28 |
| Sweden | -0.28 | -0.27 | 0.01 | -0.43 | -0.26 | 0.17 |
| Germany | -0.27 | -0.13 | 0.14 | -0.45 | -0.12 | 0.33 |
| Belgium | -0.23 | -0.18 | 0.05 | -0.57 | -0.17 | 0.40 |
| Denmark | -0.23 | -0.40 | -0.17 | -0.39 | -0.39 | 0.00 |
| France | -0.17 | -0.14 | 0.03 | -0.32 | -0.13 | 0.19 |
| Finland | -0.14 | -0.23 | -0.09 | -0.32 | -0.22 | 0.10 |
| Austria | -0.12 | -0.20 | -0.08 | -0.36 | -0.19 | 0.17 |
| Italy | -0.12 | -0.02 | 0.10 | -0.31 | 0.00 | 0.31 |
| Luxembourg | -0.11 | -0.59 | -0.48 | -0.64 | -0.58 | 0.05 |
| UK | -0.11 | -0.23 | -0.12 | -0.57 | -0.22 | 0.35 |
| Ireland | 0.71 | -0.31 | -1.02 | 0.07 | -0.29 | -0.36 |

* Without the UK rebate.
*Source*: EU budget 2006. Financial Report, Annex 5, p. 63. Office for Official Publications of the European Communities, Luxembourg, 2007. ; own estimations.

**Table 2**

Net beneficiary member states: comparison of real and estimated net financial positions in 2006 and 2013, in % of GNI

| Member state | Current regime 2006 (fact) | New regime 2006 | Difference 2006 new/current | Current regime 2013* | New regime 2013 | Difference 2013 new/current |
|---|---|---|---|---|---|---|
| | | | deviation in % points | | | deviation in % points |
| | (1) | (2) | (2)-(1) | (1) | (2) | (2)-(1) |
| Lithuania | 2.52 | 2.59 | 0.07 | 3.57 | 1.66 | -1.91 |
| Malta | 2.09 | 1.06 | -1.03 | 1.43 | 0.72 | -0.71 |
| Latvia | 1.63 | 2.57 | 0.94 | 3.04 | 1.57 | -1.47 |
| Estonia | 1.4 | 1.62 | 0.22 | 2.76 | 0.86 | -1.90 |
| Hungary | 1.35 | 1.98 | 0.63 | 3.94 | 1.61 | -2.33 |
| Poland | 1.16 | 2.61 | 1.45 | 2.99 | 1.98 | -1.01 |
| Slovakia | 0.76 | 2.11 | 1.35 | 2.87 | 1.44 | -1.43 |
| Slovenia | 0.49 | 0.68 | 0.19 | 1.06 | 0.37 | -0.69 |
| Czech Rep. | 0.36 | 1.35 | 0.99 | 2.42 | 0.95 | -1.46 |
| Cyprus | 0.73 | 0.35 | -0.38 | -0.29 | 0.12 | 0.40 |
| Spain | 0.4 | 0.13 | -0.27 | 0.00 | 0.14 | 0.14 |
| Portugal | 1.54 | 0.74 | -0.80 | 1.37 | 0.76 | -0.61 |
| Greece | 2.68 | 0.44 | -2.24 | 1.34 | 0.47 | -0.88 |
| Ireland | 0.71 | -0.31 | -1.02 | 0.07 | -0.29 | -0.36 |

* Without the UK rebate.
*Source*: as in Table 1

**Table 3.**

Net payer member states: comparison of estimated net financial positions before and after forthcoming enlargements, in % of GNI

| Member state | New regime 2013, EU-27 | New regime 2013, EU-33 | New regime 2013, EU-34 | EU-33 compared to EU-27 | EU-34 compared to EU-27 |
|---|---|---|---|---|---|
| | | | | deviation in % points | deviation in % points |
| **Netherlands** | -0.28 | -0.31 | -0.37 | -0.02 | -0.09 |
| **Sweden** | -0.30 | -0.32 | -0.38 | -0.02 | -0.09 |
| **Germany** | -0.16 | -0.19 | -0.27 | -0.03 | -0.10 |
| **Belgium** | -0.21 | -0.24 | -0.31 | -0.03 | -0.10 |
| **Denmark** | -0.42 | -0.44 | -0.49 | -0.02 | -0.07 |
| **France** | -0.17 | -0.20 | -0.27 | -0.03 | -0.10 |
| **Finland** | -0.25 | -0.28 | -0.35 | -0.03 | -0.09 |
| **Austria** | -0.23 | -0.25 | -0.32 | -0.03 | -0.10 |
| **Italy** | -0.05 | -0.08 | -0.17 | -0.03 | -0.12 |
| **Luxembourg** | -0.60 | -0.62 | -0.65 | -0.01 | -0.05 |
| **UK** | -0.26 | -0.28 | -0.35 | -0.03 | -0.09 |
| **Ireland** | -0.33 | -0.35 | -0.41 | -0.02 | -0.08 |

*Source*: Own estimations.

**Table 4.**

Net beneficiary member states: comparison of estimated net financial positions before and after forthcoming enlargements, in % of GNI

| Member state | New regime 2013, EU-27 | New regime 2013, EU-33 | New regime 2013, EU-34 | EU-33 compared to EU-27 | EU-34 compared to EU-27 |
|---|---|---|---|---|---|
| | | | | deviation in % points | deviation in % points |
| **Spain** | 0.09 | 0.05 | -0.05 | -0.04 | -0.14 |
| **Portugal** | 0.68 | 0.62 | 0.47 | -0.06 | -0.21 |
| **Greece** | 0.39 | 0.35 | 0.22 | -0.05 | -0.17 |
| **Lithuania** | 1.53 | 1.45 | 1.22 | -0.09 | -0.32 |
| **Malta** | 0.64 | 0.58 | 0.43 | -0.06 | -0.20 |
| **Latvia** | 1.44 | 1.36 | 1.14 | -0.08 | -0.30 |
| **Estonia** | 0.77 | 0.71 | 0.55 | -0.06 | -0.22 |
| **Hungary** | 1.49 | 1.40 | 1.18 | -0.08 | -0.31 |
| **Poland** | 1.83 | 1.74 | 1.48 | -0.10 | -0.35 |
| **Slovakia** | 1.32 | 1.24 | 1.03 | -0.08 | -0.29 |
| **Slovenia** | 0.30 | 0.26 | 0.14 | -0.04 | -0.16 |
| **Czech Rep.** | 0.86 | 0.80 | 0.63 | -0.06 | -0.23 |
| **Cyprus** | 0.06 | 0.03 | -0.07 | -0.04 | -0.13 |
| **Bulgaria** | 4.62 | 4.43 | 3.92 | -0.19 | -0.70 |
| **Romania** | 3.26 | 3.12 | 2.73 | -0.14 | -0.53 |

*Source*: Own estimations.

# EU budget review: the position of Poland's Government and of Polish experts

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## Introduction

The first part of the paper draws on the official position of the Polish Government as presented in the reply to the Commission's consultation paper on the review of the EU budget[1]. The second part contains an overview of the main points of discussion on the changes in the EU budget as expressed by Polish experts.

## The Polish Government's position

Poland is of the opinion that the debate on the review of the EU financial system is crucial for the EU not only for economic reasons (size of compulsory contributions of Member States to the budget, size of transfers and related advantages, etc.), but first of all because "A debate about the future of the European budget is inseparably linked to a discussion on the future of the European Union[2]. As a matter of fact this is a debate about the vision of the European integration". In other words, the ability to finance the EU and its policies has a serious impact on the speed and pattern of the integration process. Of course, the achievement of the EU objectives can take place in many cases by means of non-financial instruments. It's true also, however, that the efficiency of many EU policies depends much on the possibility to implement (and finance) these at EU level.

As the budget is so important for the future of EU integration, the main objective of the discussion on the reform of this budget should not be just a change in the distribution of its financial means. The main guiding rule of the budget review should be, according to Poland, "the aim for deepening of integration and improving the effectiveness in attainment of jointly set goals".

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[1] *Poland's reply to "A Public Consultation Paper in View of the 2008/2009 Budget Review"*, http://www.ukie.gov.pl/WWW/en.nsf/0/1F9FED51C44C6CC1C12573F400353F2F.
[2] *Poland's reply to " A Public Consultation Paper* ...", op.cit.

One of the crucial issues in this debate is the size of the EU budget. Poland is against further reduction of the budget. Continuation of the European budget reduction trend will make impossible meeting old and new challenges. Poland stressed that in recent years the EU budget increased in real terms but its relative size (share of total GNI of the EU Members) has shrunk (below 1% of EU GNI, in terms of payments actually executed), even though the Union has enlarged and taken on new policy responsibilities. The budget reduction trend will be, unfortunately, continued also in the 2013 time perspective. Let's stress that the size of the EU budget is not so much a question of increase of its level but rather it's a question of the size of its spending: in recent years the actual payments were much below the ceiling level of the budget[3]. Poland stressed that budgetary discipline should remain one of the design principles of the EU budget. However, budgetary discipline must not – as it used to be so far - lead to a deeper reduction of the EU budget than of national budgets.

Poland assesses positively the long term perspective offered by the multi-annual Financial Perspectives. Such long-term approach enables continuity of actions specified in strategies and programmes, thus creating stable frameworks for all actors, beneficiaries of the EU budget. The advantage of multi-annual programming of financial frameworks is that it also enables coordination and cohesion of actions carried out at the Community level, with measures deployed in the member states and regions. There is no doubt that the multi-annual character of Financial Perspectives should be continued.

Poland addressed also the issue of future financing of the EU budget stating that contributions to this budget "should be to a greater extent based on entities benefiting from single market freedoms, and from deepening economic and monetary integration, and to a lesser extent they should be based on direct financing from national budgets". We read also that "The method of EU financing should reflect the state of harmonization of individual policies within the EU. The economic entities and sectors that derive the greatest benefits from European integration should bring the biggest contributions into the EU budget financing. In this way, development of Community policies would contribute to expansion of the system based on EU own resources". No concrete types of new resources have been, however, suggested.

[3] According the Polish document "If 2007-2013 Financial Perspective maintained the spending level in relation to GNI of the EU at 1993-1999 value, we would have at our disposal additional EUR 200 billion for implementation of European policies. For the sake of comparison, the aggregate seven-year budget of the Seventh Framework Programme for Research and Technological Development amounts to mere EUR 50 billion (in 2004 prices)".

Accepting the view that a lot of new development challenges are ahead of the EU, Poland stressed that if those challenges are to be effectively met, it is absolutely necessary to strengthen the Union's cohesion. Enhanced cohesion should include both, its social-economic and territorial dimension. In other words, Poland argues that the degree of the Community's cohesion will determine the ability of the EU to adapt to structural transformation. Without further cohesion, the disparities in development levels will constitute a barrier to the deepening of integration.

At the same time, cohesion should not aim merely at reducing the gap between less and more developed EU areas. The common budget (and its spending) should also support other goals, actions aimed at growth and jobs, by promoting development and flow of knowledge through educational and research programmes, mobility, competitiveness and innovation. The EU budget should also contribute to addressing new challenges, including climate change and adaptation to the effects thereof. These objectives can be coped with, at least partly, in the framework of existing policies, including cohesion policy and CAP.

Generally, taking into account the numerous challenges and at the same time the fact that spending from the EU budget will remain limited, Poland suggests that the common budget "should play the role of a mechanism serving the purpose of attaining convergence at the level of EU goals, policies and their practical implementation consistently across all member states". In this context, it is important to remember that other policies, including CAP, also contribute to the fulfillment of cohesion objectives.

With regard to CAP, Poland stressed that this policy has already changed much as a result of several reforms implemented in the previous years. It is not focused any more, as it was the case in the past, on supporting prices of agricultural products. The present CAP supports to a great extent farmers' incomes and enables farmers to make free production-related decisions depending on signals from the marketplace and strengthens competitiveness of the agricultural sector. Moreover, it also serves the implementation of natural environment protection and other goals.

Generally, Poland is against rebates. The strongest opposition is formulated in the following sentence: "One should aim at removal of all mechanisms and rebates from the EU own resources system". Poland stresses also that "own resources system based on GNI-based payments is not only the simplest but also the fairest one". This resource is the biggest one (around 75% of total resources of the EU budget in 2009). In practice, the dominant role of "payments into the EU budget based on GNI leads to a result contradictory with the one intended – relative encumbrance with contributions to the budget from less affluent states go up". The reason for that is, that Member States adopt the famous *juste retour* logic and compare payments with transfers they get back. So, the more transparent the payments system is, the higher the temptation to adopt this logic. "As a result, while tax systems in almost all member states have a progressive character, i.e. they impose the largest burdens on the wealthiest tax-payers, as a result of the applied correction mechanisms the Community own resources system has a digressive character, imposing greater burdens on less affluent member states and citizens".

So, Poland is against correction mechanisms but it is not a very direct critique of the British rebate and of other rebates in general. Why? This is one of the sensitive issues for Poland and we'll come back to that later.

Opinions of Polish experts

A number of workshops and conferences were organized in Poland in the framework of public consultations. Also, numerous publications have been issued with regard to the budgetary issues[4]. In the framework of these consultations, the Office of the Committee for European Integration commissioned a number of expertises and organized several conferences[5].

The most common opinions on individual issues of the EU financing system are presented below. These include opinions of individual experts as well as quite representative opinions of Polish entrepreneurs expressed by PKPP Lewiatan (Polska Konfederacja Pracodawców Prywatnych Lewiatan – Private Enterpreneurs Lewiatan, later referred to as Lewiatan[6]).

*Own resources system (financing)*
*a/ size*

Lewiatan considers the EU budget as the most import instrument of conducting EU policies, allowing for gradual reduction of the gap in the levels of economic development of EU Member States and regions and mitigation of sectoral problems of economic and social character. Poland is a good example of a big beneficiary of the transfers from the EU budget, catching up quickly with the more developed EU Members. It's also true, however, that the spending of this budget has not been keeping up with old and new challenges faced by the EU.

The Association of entrepreneurs does not suggest any increase of the present ceiling of the EU budget (1.24% of the combined GNI of the EU). It stresses, however, that the size of the budget and ways of its financing as

[4] The illustrative list of such publications is presented in bibliography.
[5] More on this issue: http://polskawue.gov.pl/Przeglad,budzetu,UE,w,latach,2008-2009,230.html
[6] *Stanowisko PKPP Lewiatan w sprawie propozycji reform polityki budżetowej Unii Europejskiej*, Warszawa, kwiecień 2008 (SEC(2007)1) [*Position of PKPP Lewiatan on the proposal of the reform of the European Union's budgetary policy*, Warsaw, April 2008].

well as the goals and criteria for spending should be modified in order to allow the EU to better cope with the new challenges.

Few researchers in Poland argue for a higher budget. Everybody is aware of the fact that higher budget would result directly in increased contributions to be paid by all EU Member States including Poland, without the guarantee of higher transfers to the Polish economy. Only politicians call, from time to time, for an increased EU budget – to get the sympathy of the public opinion - but without much support from experts. The implicit assumption (which is certainly wrong) underlying such an approach is that higher budget will offer more money for the domestic economy.

*b/ juste retour logic*

*Juste retour* logic is heavily used by the media and is clearly present in the national political debate. Polish experts are, however, univocally against this way of thinking, as *juste retour* logic is an unjust criterion of assessment of the EU budget[7].

The meaning of the EU budget for the EU and its individual Member States should take into account not only the net position (balance) vis-à-vis the EU budget. Many activities can be realized much more effectively when they are centrally financed (synergy effects). Moreover, advantages of projects in one country often go to neighbouring countries (e.g. a good transport infrastructure in one of the countries serves all the vehicles in transit). There are also learning effects (exchange of experience, of best practices, etc) involved. So, the EU budget finances a number of public goods which are available at the European, as opposed to the national, level. Other examples of areas referred to as European public goods, include, protection of the environment, maintaining food security and safety, promoting.

*c/ resources*

Probably everybody can find at least one good argument to criticize the present system of the EU financing and usually the list of such critical opinions is much longer[8]. That does not mean, however, that in view of such critique all countries will agree easily on a new system.

Like in other countries, a number of proposals have been discussed in Poland with regard to a new resource of the EU budget. In this area,

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[7] J. Pietras, *The future of the EU budget* … op.cit.

[8] Critical remarks expressed by Polish authors stress the same weak points of EU financing that were presented in well known reports, e.g. A. Lamassoure (*The System of Own Resources*, *Questionnaire for National Parliaments*, 26 X 2005).
http://www.europarl.europa.eu/meetdocs/2004_2009/documents/dv/qownres_/qownres_en.pdf) or by the Commission (*Financing the European Union. Commission report on the operation of the own resources system*, COM(2004) 505 final, Volume II, Brussels 2004, 14.7.2004).
A. Lamassoure, *The System of Own Resources … op.cit.*

however, opinions of various authors are more differentiated than with regard to other issues.

Polish entrepreneurs associated in Lewiatan are against any resource that would require first harmonization of taxes, e.g. CIT or European tax. According to this opinion, the explanation lies in the fact that differences of national fiscal systems are the natural consequence of different economic levels and different models of social consumption. A new resource could be based on (a) taxing use of energy or damages to the environment and on (b) European VAT which would replace the present statistical VAT (VAT has been already harmonized). Other candidates worth consideration are: taxes paid by beneficiaries of EU common policies, although such proposals still require detailed studies.

The European VAT (called also a modulated or fiscal VAT) is considered also by some Polish experts as one of the possible candidates for an own resources based EU budget, provided some problems are solved[9]. European VAT assumes that one or two percentage points of the national VAT rate in each Member State is transferred directly to the EU budget[10]. The main arguments in favour of this proposal are: broad tax basis, relatively high (but still insufficient for this system) level of harmonization of VAT in the EU Member States, high visibility of this tax for taxpayers, the fact that it would be based on a tax that is already used at the EU level.

A considerable drawback of this proposal is that some EU Members have a lot of 0% VAT rates[11] and, for that reason, would object the implementation of a new tax on the ground that it increases the tax burden for the society. Also, one may expect that the tax collection cost would substantially increase (new accounting programmes to be introduced by providers of goods and services, etc.).

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[9] See more: E. Kawecka-Wyrzykowska, *VAT jako źródło dochodu budżetu europejskiego, ekspertyza dla UKIE (VAT as a resource of European budget,* expertise for the Office for the Committee of European Integration, non-published paper*,* Warszawa, styczeń 2008) and: J. Wtorek, W. Burkiewicz, *Podatek europejski jako element przeglądu budżetu UE*, (*European tax as an element of the review of EU Budget*), „Biuletyn Analiz", nr 18/luty 2008, UKIE

[10] The amount of the EU tax would be clearly differentiated from the amount levied for the national VAT on the invoices. An important advantage of this system would be that both, national parliaments and the EU would be granted the power to determine separately which rate would be imposed for purposes of the national budget and which for the EU budget, respectively, see: P. Cattoir, *Tax-based EU own resources. An assessment*, "Working Paper" no 1/2004, European Communities.

[11] For the United Kingdom, the zero rate base is around 20% of the whole taxable base. In other words, a fifth of the whole taxable base is actually not taxed and is not subject to VAT payments and therefore no VAT receipts for the government budget. The share of the zero rate base for Ireland is also large with 12% of the taxable base, see: A. Mathis, *VAT indicators*, "Working Paper" No 2/2004; European Communities.

Experts are also looking for a tax that is related to benefits emerging from the European integration, in particular from the high mobility on the single European market. Contributions to the budget of entities which take advantage of the single market should be proportional to the benefits drawn by those entities from the single market. Of course, it's difficult to implement such a system but not impossible. Such type of own resource items for the EU budget, as J. Pietras has suggested, among others, could be a tax on windfall profits, or income from seigniorage of the European Central Bank[12]. This proposal "is not about introducing an European tax in the strict meaning of the term. It is about a principle saying that if an EU instrument generates benefits for states or economic operators, it would be natural expect that those who benefit contribute to the common budget". In addition, also those operators making the functioning of the single market more difficult (therefore depriving others from otherwise possible benefits) should contribute to the EU budget. A similar concept underlies the proposal for a tax related to environmental protection, in particular a tax on emission of CO2[13].

Of course, each proposal put forward by specialists has to be thoroughly analysed.

Summing up, a widely visible, universal European tax would be probably the best candidate for the EU own resources system. This would reduce the interest of countries to calculate their net positions, thus eliminating (or at least mitigating) the problem of political bargaining around the contributions. However, in practice, does not exist a good and easily accepted tax (an ideal tax), both in the national systems and in the EU[14].

Thus, taking into account the fact that there is no optimal tax, "the precise choice of resource ... is seen as a second-order question to be determined more by the preferences of decision-makers than on purely objective criteria"[15].

*d/ correction mechanisms (rebates)*

With regard to the rebates, which in practice substantially modify the amount of money paid by individual countries to the common budget, the

[12] J.Pietras, *The future of the EU budget* … op.cit.

[13] The burden of such a tax would be different for individual countries. France (companies and other operators) benefiting from the atomic energy would pay relatively little (relative little would be collected from French units emitting CO2) as compared to countries relying much on coal energy, like for example Poland.

[14] The room of manoeuvre regarding such a tax is limited by many conditions which have made its introduction difficult for a number of years. It should be neutral from the point of view of the tax-payer, that is it should not introduce new tax burden but rather replace the existing national one. It should also be easy to collect and it should not increase the administrative burden.

[15] P. Cattoir, *Tax-based EU own resources ... op.cit.*

position of Lewiatan is - similar to the government's position – an ambiguous one: "the phasing out of British rebate requires a long-term approach because of its connection with possible implications of the reduction of financial means for CAP, as well as because of possible consequences in form of excessive reduction of expenditures in other areas of the EU budget". In both cases (government's position and Lewiatan's position), somehow surprisingly, we do not find an open critique of the rebates. Why?

It seems obvious that the discussion on a new resource system would be an opportunity to start discussion on elimination of the British rebate and other correction mechanisms. It is equally obvious that the UK won't accept elimination of its rebate easily. Previous discussions and official negotiations (especially the last ones on the present Financial Perspective which were completed in December 2005) suggest that the UK would be ready to give up its rebate under the condition that financing of the CAP from the common budget is substantially reduced. In practice, such solution would have to result in taking over part of the burden of CAP financing by national budgets, i.e. re-nationalization of the CAP.

Such an approach is not acceptable for Poland. Poland does not agree to make discussion on the elimination of the British rebate dependant on the reform of CAP. There are a number of reasons for that. As already mentioned, CAP has been subject of important reforms for a long time. Further reforms are required and these should depend on the objectives of integration in the agricultural sector (e.g. increased efficiency of the sector) but not on a position of one or of a few countries. What is equally important is that re-nationalization itself would be a bad choice (see more in the next point). As J. Pietras rightly noticed, in this context "the only aspect they have in common is the historical background of their functioning in the present form" [16] (in both cases it was a different situation).

As long, as the UK makes decision on elimination of its rebate dependant on re-nationalization of the CAP, the room for maneuver is very limited and for Poland it's too risky to be openly against the rebate. The price of elimination (in form of re-nationalization) might be too high for Poland.

*Spending*

Cohesion, considered by the government as the priority of the EU spending, seems to be first on the list of key projects also among experts. There are, however, slightly different approaches when it comes to more detailed understanding of this policy.

[16] J. Pietras, *The future of the EU budget* … op.cit.

One can find authors favouring stress on infrastructure while others argue that Poland should shift interest more towards innovations[17]. Everybody has to admit that Poland lacks good infrastructure via-a-vis higher developed countries and that well developed infrastructure is a condition for efficient trade in goods, flow of people etc. From this point of view, Poland has to spend money on such goals, be it from domestic budget or from the EU funds. It's also true that in order to be competitive, Poland has to invest much more in innovations, new technologies etc.

Arguing for continuation of relatively big spending on a broadly understood cohesion policy, experts stress its wider advantages which go not only to direct beneficiaries but also to many other units.

Polish specialists stress also the importance of procedures. Formal control of compliance with procedures is not sufficient, is not enough as "The control of EU spending should concentrate to a greater extend on measuring results of undertaken actions and their impact on the achievement of long-term European objectives and not only on checking of compliance with procedures"[18].

Albeit many Polish economists are critical with regard to the previous CAP, the majority of them generally support the official position. They are of the opinion that:

1/ CAP has already changed much to become a more effective tool of supporting agriculture and rural areas development. The money spent on CAP was decreased much in recent years. What is even more important, the instruments of agricultural support have been modified substantially and nowadays they distort the market much less than several years ago.

2/ In the next Financial Perspective, the CAP should be continued at the EU level. It should remain the common EU policy, including common instruments and common financing. Without such uniform approach there is a risk of distortions on the single European market. More affluent countries would be able to offer higher support for their farmers, thus distorting the market by placing the other farmers in a worse competitive position. Certainly, Polish farmers would find themselves in a worse competitive position as the government would not be able to offer support as big as that offered by richer partners. In other words, there is a common

[17] See discussion on that in: T.G. Grosse, *Jaka przyszłość polityki spójności?* "Analizy i Opinie" Nr 80, Instytut Spraw Publicznych, Warszawa, styczeń 2008 (*What future of the cohesion policy*? „Analyses and Opinions").

[18] Opinion expressed by J. Olbrycht, Member of the European Parliament, Conference "Reforming budget, changing Europe", Brussels, 12.11.2008.

opinion in Poland that the idea of re-nationalisation of the CAP is a wrong proposal.

A similar approach is reflected in the Lewiatan's expertise. The Polish Confederation of Private Entrepreneurs is of the opinion that the expectation to reduce the spending on CAP can be justified. However, more important than that is ensuring the transparency of agricultural markets and equal (fair) competition rules. For those reasons, any reduction of funds for CAP should be associated with parallel protection against any increase of national public support for the agricultural sector, very probable in case of re-nationalisation of CAP.

The fundamental risk associated with adoption of the principle of co-financing is the possibility of distorting the conditions of competition, i.e. increased financing of agriculture in those Member States which are able to do so.

At the same time, Lewiatan argues that the re-consideration of the present pattern of expenses is required and, for example, reduction of direct payments for big farms is needed as well. Also, part of direct support should be moved towards modern programmes of the development of rural areas and agricultural infrastructure, including research, telecommunication, and managerial services.

It is necessary to add that debate on the future of CAP and working out an official position vis-à-vis partners in the EU is particularly sensitive in Poland, taking into account such factors as: a big share of population directly or indirectly linked to agricultural production (15-16% of total workforce is employed in agriculture plus their families plus employment in food industry and other industries), participation of the Farmers' Party in the present government coalition, unclear effects of the CAP reform of 2003 on Polish agriculture (in particular of cross-compliance). They don't help prepare the position focused exclusively on economic arguments and based on economic efficiency.

## Conclusions

Experience shows that simple and transparent solutions, so much needed, required and supported from the economic point of view may prove to be unacceptable by individual countries, be these big players or small actors. This is one of the reasons explaining historical rebates and smaller transitional extra-solutions agreed upon on the occasion of political deals (final negotiations) on the budget (e.g. a long list of special arrangements adopted in December 2005 to enable a compromise on the Financial Perspective 2007-2013).

Paradoxically, the simpler the system of financing the EU budget, the more difficult it will be to get acceptance for such a solution (the net position will be easily calculated for each country encouraging discussion on "too big" net cost or "too small" net transfer vis-à-vis the EU budget).

Taking into account the strong fight for the compromise in December 2005 when the present Financial Perspective was agreed upon, positions of governments presented so far, recent financial (and economic) crisis and resulting pressures to stabilize national financial positions, one should not expect any radical changes in the system of EU budget, at least with regard to its financing.

The final phase of budgetary negotiations will quite possibly coincide with Polish presidency in the EU (the second half of the year 2011). This imposes a particular responsibility on Poland to contribute to the final outcome of those negotiations. It means, first of all, the ability to coordinate efficiently the proposals put forward by individual Member States and the readiness to make compromises to allow the budget to adjust to new challenges.

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# The EU Budget Reform –Upcoming Debate from the Czech Perspective

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## Abstract

This paper aims at assessing ongoing and upcoming debate on reform of the EU budget for the post-2013 period. It analyses the current state of play looked at both the income and expenditure sides of the budget. It mentions main arguments against excessive CAP expenditures and the complicated system of resources as well as major obstacles impairing an in-depth reform. The paper also looks in detail on the Czech national position towards the budget reform debate. The paper suggests EU budget should be thoroughly reviewed on the basis of the fiscal federalism criterion which evaluates the added value of the European dimension of spending.

## Introduction

After the Lisbon Treaty has come into force, protracted institutional debates have ended and the Union could now focus on its policies at last. One of the main issues the EU will be dealing with during the upcoming years is the reform of the budget. First of all, the EU will have to adopt a new financial perspective for the period of 2014-2021. Furthermore, the 2005 deal on the 2007-2013 perspective contained the condition of a fundamental review of the EU spending with special focus on reform of the Common Agricultural Policy (CAP). Under this condition the United Kingdom agreed with phasing out of its rebate and keeping the agricultural subsidies at its current level of more than 40% of the EU budget. The first phase of the CAP reform took place in 2008 with the so-called “health check” of agricultural expenditures. It was decided to abolish dairy quotas, bolster rural development and cut direct subsidies. This deal will expire in 2013 when an in-depth reform will have to be adopted. It is questionable whether the current economic crisis context creates favourable circumstances for an in-depth reform of the EU budget. Crisis usually represent occasions for fundamental changes. Nonetheless, stretched public finances of all EU members give arguments to net contributors for reducing the budget with regard to the fact that some net payers contribute more than others. On the other hand, net beneficiaries would welcome increased solidarity and greater spending in order to boost economy. Such contradictory logic may therefore impair chance for a successful reform. Another but also symptomatic contradictions can be found in the positions of some new member states, notably the Czech Republic. Those countries on the one hand assert the need for reform but, on the other hand, they have an interest to maintain the advantageous status quo.

## Positions of the Commission and the Presidency trio

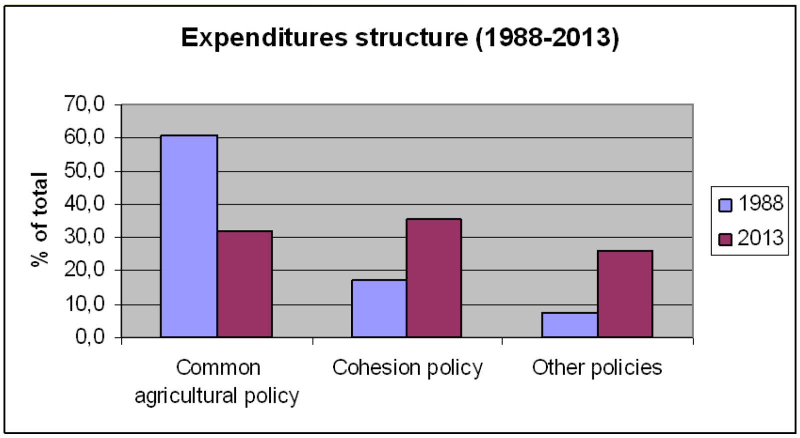
The second Barroso Commission already announced its plan to make the budget reform one of its top priorities. In its 2020 vision the Commission outlines basic stance on the issue of CAP reform developed further in public consultation documents. The Commission insists upon agriculture having its place in the EU expenditure but must undergo adjustments in order to be modernized for 21$^{st}$ century needs and respond to challenges such as food security, water scarcity or climate change. The Commission launched a public consultation procedure and organized a top-level conference dedicated to the EU budget reform, being followed by a number of European think-tanks working on the issue, too (CEPS, Notre Europe etc.). The public consultation results reflected the general perception of needs and expectations regarding outputs of the European Union. According to them, the EU budget should mainly cover competitiveness (research and development), energy security and environment (climate change).

The budget reform will be a challenge for the next Presidency trio as well. The upcoming three presidencies are supposed to lead the debate on behalf of the EU Council on the Commission reform proposal. Nonetheless, the concrete negotiations on the budget reform will not take place before mid-2011 when the Commission is due to present its proposals for the next financial perspective. The Spanish Presidency is expected to launch discussion on a new “Lisbon Strategy” and its interconnection with the current economic crisis. Such debate could affect budget reform discussions to a large extent, as the Spanish presidency may try to link the two issues together. Future competitiveness strategy discussion is likely to put main emphasis on the area of research and development and a knowledge-based economy as preconditions for sustainable growth in Europe while similar arguments are used in the budget reform debate. On the other hand, the Hungarian Presidency, the last of the trio, will probably stress the importance of regional policy as all new member states oppose cuts in this kind of spending from which they profit a lot.

## Pitfalls of the budget debate

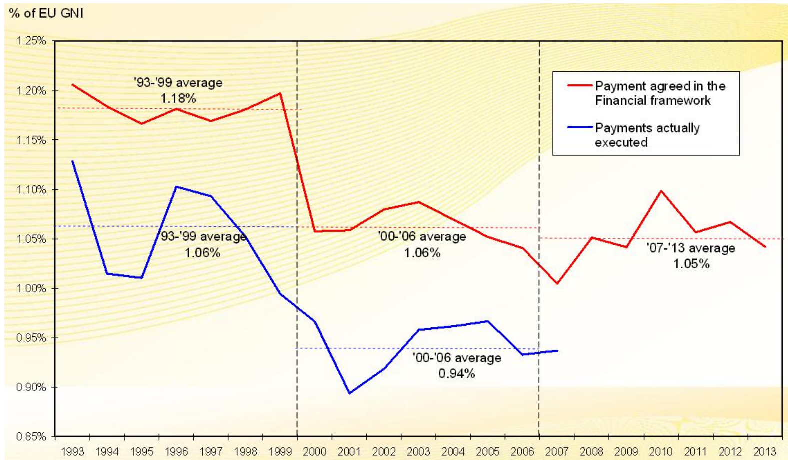
The EU budget debate is an extremely complicated one, as there are two dimensions to it: 1) How much money will be put together and spent (questions of resources); 2) Where the money will be allocated (question of policies)? These two dimensions cannot be treated separately and there is a need for a complex view and comprehensive approach.

The EU budget is generally considered outdated and the structure of its expenditures reflects the national desires to get back as much as possible from the EU budget (the logic of "juste retour") and does not reflect the real needs of Europe's economies and societies. There is an "evergreen discourse" that with the reform, more money should be allocated to R&D, infrastructure or internal and external security whereas less or no money to agriculture or regional development. Such a critique, however, omits the fact that proportion of CAP expenditure has been constantly decreasing (see chart 1).



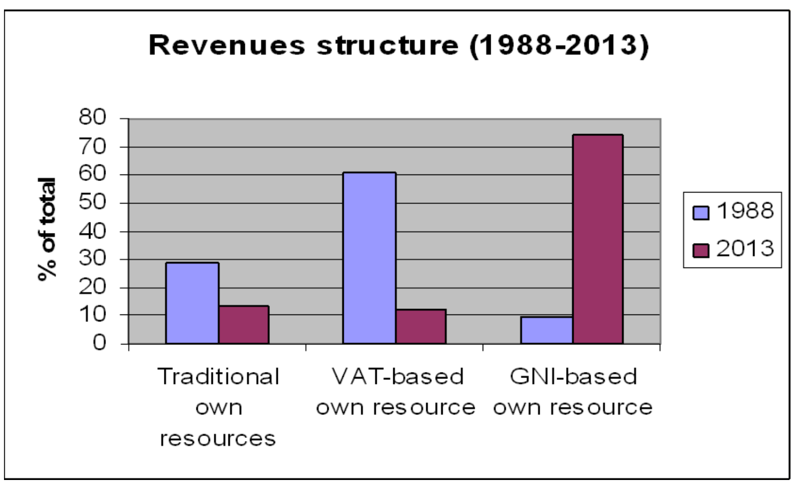

*Source: European Commission*

On the other hand, solidarity between the rich member states and the poorer ones should be embedded in the EU budget. This principle, however, has been substantially weakened by the above-mentioned logic of "juste retour" and by the decreasing tendency of the overall EU budget relative proportion (see chart 2). While there is a cap for the EU budget proportion (1.27% of the GNP), there is no bottom limit which would provide more long-term stability to EU financing. Progressive decreasing of the budget in both absolute and relative terms is a real threat, especially at time of economic crisis.




*Source: European Commission*

The income side of the budget will definitely have to be subject to a reform. The system of traditional own resources (import duties) and VAT-based own resources has become very complicated and obscure with so many correction mechanisms. General tendency is to abandon own resources system and finance the budget only from GNP based nation contributions, which would only confirm the tendency traceable for some time already (see chart 3).




*Source: European Commission*

Some suggest introducing a European tax which would provide resources to the budget and bring citizens closer to the EU and make them more sensitive to EU issues. Such an impact on the citizens is, however, very arguable; most people still do not see tangible benefits of the EU membership and media often creates an image of the EU as an institution producing numerous useless regulations. If a special direct European tax was imposed on citizens these may become even more discontent with the EU.

Similarly, Daniel Gros from CEPS suggests that the financial perspectives should be synchronized with the mandate of the European Parliament so that the EU's only directly elected body would gain even more importance in the people's eyes and could thus profit from increased elections turnout. On the other hand, the European Parliament has gained substantial budgetary powers and its role in this area is further reinforced by the Lisbon Treaty while positive impact on elections turnout has not been noticed.

Although all main recipes for a better EU budget are known and generally accepted, the debate follows the Catch-22 logic. Everybody knows what must be done, nevertheless the deal will be difficult and it will probably take form of a compromise reconciling all national interests (in getting back as much money as possible). The vicious circles cannot be broken unless the political will for a fundamentally different EU budget is found in all countries. Net contributors should accept the prospect of "no money back" (at least in the short-term) and the net beneficiaries should embrace the view of less solidarity of the rich with their poorer regions. Above all, there is France, Poland and Romania and politically influential farmers who should be willing to give up their generous agriculture subsidies. However, none of those actors would be willing to surrender easily and the 2011 reform is thus threatened from the very beginning. Furthermore, a new conservative government in the United Kingdom may turn into a real obstacle to any kind of compromise. British pressure for reform of the budget will be enormous; however the "Thatcher logic" of "I want my money back" could easily prevail in minds of British government politicians. Although Tony Blair and Gordon Brown accepted phasing-out of the British rebate in 2005, it is not assured that the Conservatives would not revoke such a decision.

## Czech ambivalent stance

The Czech government and major political parties perceive the need for the budget reform. Czech Republic has embraced a liberal discourse within the EU and openly advocates liberal reforms in the EU policies - limiting redistributive policies and supporting investments for the future. However, the Czech Republic has its own stakes, too, in current state of play, so its stance is in fact much more ambivalent than it seems at first glance.

As far as the income side is concerned, the Czech Republic supports the general tendency towards abandoning of VAT and customs bases resources altogether with all correction mechanisms. The country advocates clear system of GNI based resources and rejects the idea of a European tax.

The expenditure side from the Czech perspective seems to be much more unclear. At present, the Czech Republic is a net beneficiary and opposes efforts to decrease the total volume of the budget. In contrast, after 2013 the country may turn into a net contributor which is a prospect to be avoided but anticipated and assumed.

General stance of the Czech Republic consists of keeping the regional (and cohesion) policy and reducing the CAP. Regional policy and structural funds are a huge domestic political issue (politicians and parties blame each other for bad absorption capacity and promise improvements in utilising the funds). The absorption capacity of the country has been steadily improving and any prospect of cutting those expenditures in the future is an unpleasant one.

The official Czech discourse mentions the CAP reform as a necessity. Money saved on CAP could be allocated to more reasonable goals such as education, research or energy security (the Czech Republic especially advocated energy infrastructure projects, e.g. Nabucco). By contrast, climate change agenda which is one of the top candidates for new reformed EU expenditures is not raised as a priority of the Czech Republic at all.

Nonetheless, when assessing the Czech position towards CAP more in detail, one can see that the pro-reform mood is far from being a matter of course. The overall Czech population working in agriculture is relatively low (4.3%), in some regions however it is more than 10%. Farmers have been facing more competition and other structural problems (lowering prices) and are more prone to asking (quite loudly sometimes) for state support. Czech farmers have been recently very critical towards tendencies in reforming the CAP. Those inclined to re-orient support from bigger enterprises towards smaller farms in order to foster rural development whereas Czech farms are rather big (heritage of Communist collectivisation).

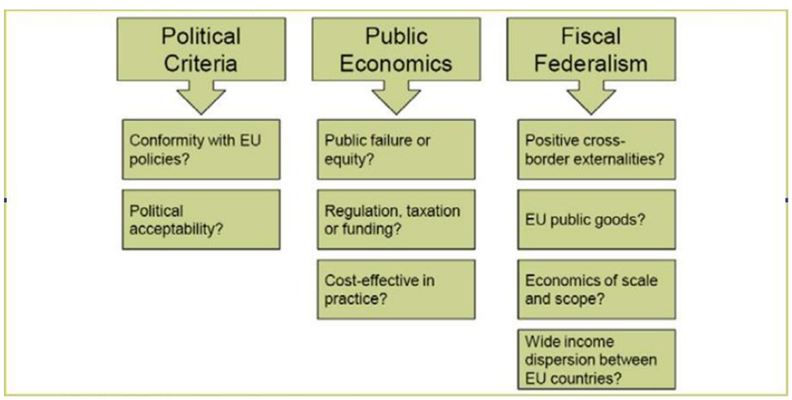
However, the main problem is linked to the phasing-in process in direct subsidies. At the Copenhagen Summit in 2002 it was decided that farmers in new member states would not touch 100% of subsidies until 2013 (with annual increase). For that reason, the Czech farmers would categorically oppose cutting in subsidies for the period after 2013.

## Is there a way out of the deadlock?

The EU budget represents “only” 1% of the EU’s GDP. It is, however, a substantial amount of money which can make difference and produce tangible results. Undoubtedly, the budget needs a reform and this reform will be difficult to achieve. An increased role of the European Parliament, now empowered by the Lisbon Treaty to give an assent to all expenditures, could be a promising factor hinting that the upcoming negotiations could extend beyond the so far predominant (antagonistic) national interests.

In order to avoid another halfway reform, the EU main actors (Commission, Parliament and the Member States) have to adopt a holistic approach towards the budget issues. Package deals are likely to lead nowhere as well as dogmatic economic attitude arguing in favour of the complete replacing of redistributive policies with investments. What has to change is the very reasoning about the EU budget. So far, the criteria for allocations were too much political. The CAP was set-up at the political command by France and all other "costly" policies, notably regional and cohesion policy were added as a sort of compensation for those predestined to exploit them. Politicization of the EU budget decision-making, locked up by the purely national interests, is the first thing to blame when looking at the EU budget which does not correspond to real needs. Nonetheless, political logic should not be alternated by pure economic (or neo-classic) logic. The latter means that all EU money would be allocated into R&D and new technologies to the detriment of the less developed countries and regions while solidarity element would disappear; such a scenario is unlikely to happen given the strong national preferences in redistributive policies.

This paper argues that the best way to handle the EU budget reform is to embrace the "fiscal federalism" logic as a main criterion for EU funding (see chart 4).




*Source: Copenhagen Economics*

Such an approach is an analogy of the "subsidiarity principle" in the EU regulation. It consists of evaluation of expenditures on the basis of the added value at the European level. All expenditures should be assessed from the point of view of advantages of pooling capacities and spending at the EU level (e.g. positive cross-border externalities). Coherence with other kinds of EU actions has to be taken into account, too. The fiscal federalism approach would therefore downsize agricultural payments because those have been already nationalized and there is no added value of a common budget in this area. On the other hand, regional policy makes sense with regard to the fiscal federalism if cross border regions are targeted at the first place. Similarly, support to infrastructure should put emphasis on Trans-

European Networks etc. Such an assessment should be carried-out in all EU expenditures, even at the cost of complete redesigning of spending structures within EU policies.

Key recommendations for the upcoming debate:

- Adopt fiscal federalism approach and re-assess all expenditures in relation to the European level added value
- Keep solidarity element in the EU expenditures
- Introduce the bottom limit for the GNP proportion of the EU budget (e.g. 1%)
- Interconnect the budget debate with the new “Lisbon Strategy” discussions
- Abandon traditional own resources and VAT-based resources together with all correction mechanisms
- Respect the EU citizens’ expectations regarding the EU policies’ outputs

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Jacques, Le Cacheux, *Reforming the financing of the EU budget*, Contribution at the Conference „Reforming the Budget, Changing Europe, November 2008

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*EU Budget Review – Options for change*, Copenhagen Economics, June 2009

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# Hungary and the new EU budget

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Following long lasted debates with the participation of both policy-makers and academics, and based on a whole series of valuable papers[1], as well as the revised EU strategy elaborated under the auspices of the Ministry of Foreign Affairs in 2007, Hungary expressed its views on the EU budget reform in April 2008[2]. In this paper, I'll try to present these official views, comment them and, where I can, suggest some alternative solution. As the government paper goes through the questions posed in the Commission's consultation paper - *Reforming the Budget, Changing Europe* – I'll follow the same procedure.

Question:
*Has the EU budget proved sufficiently responsive to changing needs?*

<u>Answer of the Hungarian government</u>:

A reform of the European Union's budget has become necessary in order to successfully face new challenges of the 21st century (like climate change, energy security, ageing population, etc.), fulfil the Lisbon Strategy objectives and ensure a balanced development among Member States and regions across Europe. But, under the current regime, it is impossible to achieve the above goals. Why? Budapest lays the blame for this upon the member states' net balance approach, i.e. the priority of their net budgetary position over anything else. As a consequence, in the process of establishing a new Multiannual Financial Framework (MFF), firstly the expenditure ceiling is determined and only then do the members decide what the money should be spent on.

According to Hungary, firstly the basic objectives of the Community should be agreed upon; then the policies to meet these; and finally the own resources to finance the policies. Such a policy-driven budget, however, may require higher level of Community spending than is the case today, since Hungary is seeking to preserve the balance between new and old policies in such a way that subsidisation for the existing policies be ensured, too. The

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[1] For the list, see: Szemlér, Tamás (2008): Hungary. In: Szemlér, T. and Eriksson, Jonas: The Budget Review: Mapping the Positions of Member States. *SIEPS* 2008(2) April, Stockholm, Swedish Institute for European Policy Studies, pp. 110-116.

[2] Government of Hungary (2008): *Answers of the government of Hungary to the questions of the Commission raised in its communication 'Reforming the Budget, Changing Europe'* [Internet] Available from: < http://ec.europa.eu/budget/reform/library/contributions/pgs/20080401_PGS_16_en.pdf> [Accessed 27 February 2010]

latter, in practice, means – as Budapest wants important changes neither in agricultural nor in cohesion policy – that subsidy levels prevailing for the end of MFF 2007-2013 are to be maintained.

Criticism:
While it is entirely understandable that the government of a catching up economy wants to maintain those old policies providing funds for the catching up process, it is, however, not necessarily wise to claim for the parallel introduction of new common policies and admit that this could increase the Community spending when everybody knows net contributors would never agree to such an increase. Clearly, it is very difficult, for the government, to choose between maximising Community funds and showing itself as a proponent of a successful and competitive European integration.

Question:
*How should the right balance be found between the need for stability and the need for flexibility within a multi-annual financial framework? Could enhanced flexibility help to maximise the return on EU spending and political responsiveness of the EU budget?*

Answer of the Hungarian government:
The system of multiannual financial frameworks is good as it is, being stable and predictable; hence the loosening of its rules is not desirable. Enhanced flexibility might only be considered for common policies within their respective budget ceilings.

Criticism:
When it comes to flexibility, the restriction concerning its application within policies' respective budget ceilings could be softened and made somewhat more efficient by extending its validity over a longer period of time, e.g. over the whole MFF. A relevant example is the case of the Common Agricultural Policy (CAP) the financing of which, today, desperately lacks a good deal of flexibility US agricultural policy enjoys. [See: Figure 1] Simplifying to the extreme, one can say that as a result of a chain of reforms of the CAP (since 1992 onwards), a European farmer gets the same amount of subsidy in each year of the MFF, independently of weather conditions, production volume, market prices or available income; in brief: independently of whether he/she is in need of these subsidies or not. In the Unites States, an important part of the subsidies is closely related to the above detailed conditions and the system has a countercyclical character; so the more farmers need assistance, the more they get. Such flexibility is due to the fact that the subsidies are paid out of the federal budget which, in turn, is decided upon yearly basis by the MPs of only one country, the USA. In Europe, the financing of the CAP is being debated by 27 governments, laid down years ahead for the whole period of the MFF, and there is no

possibility to increase or decrease the yearly spending according to the farmers' needs.

Under the current CAP-regime – shaped as it is by the last reforms, especially the so-called Health Check in 2008 – there is no more supply control, practically no (or minimal) market intervention, hence no intervention stocks to minimise price fluctuations. Such fluctuations, however, are getting more and more extreme due to trade liberalisation process, climate events and food security scandals. The two latter factors do not need to be explained, but the former one does; by dismantling customs duties under GATT/WTO negotiations world output of a given product has been concentrating to fewer and fewer regions (certainly with comparative advantages), but if anything happens there (e.g. natural or social catastrophe) involving serious negative effects on production, an important part of the global exports will disappear from the world market causing huge price fluctuation.

Another great risk facing the CAP is stemming from the geographical vicinity of such big agricultural producers like Russia and Ukraine. In their case, the combination of a low-tech agricultural sector, i.e. very much exposed to weather conditions, and the lack of adequate storing capacity means that in years of good weather (i.e. good harvest) they are able to supply European markets at very low prices. So, any increase in the flexibility within the multi-annual financial framework is welcome.

Question:
*Do the new policy challenges set out* in the Commission's consultation paper *effectively summarize the key issues facing Europe in the coming decades? How should policy objectives be properly reflected in spending priorities? What changes are needed?*

<u>Answer of the Hungarian government</u>:
Budapest is of the view that, in order the new challenges identified by the Commission in its paper to be met, the EU budget should contribute to achieving the following key policy objectives:

- Solidarity. As the existing substantial disparities among EU members in terms of development lead to distortions and hinder the realisation of the benefits of the single market on the one hand, and the reduction of economic and social disparities would most probably create good basis for sustainable growth on the other, ensuring solidarity among member states should remain one of the main objectives of EU budget spending.
- Competitive Europe. In the era of globalisation Europe needs to do more to boost the competitiveness of its economy. In other words: to turn the Lisbon Strategy into action.

- Sustainable development. Environmental sustainability should reflect the responsibility that European countries assume towards future generations.
- Europe as a major regional and global player. As most of the regional and global challenges – such as migration, energy security, climate change, international tensions, terrorism, etc. – the Member States have to face today can only be addressed by joint action; Hungary, as a small country of the Community, supports the idea of giving priority to this objective in the next MFF.

<u>Criticism</u>:

Here priorities need to be set. Again, Hungary has little choice but to place cohesion policy first among its priorities, closely followed by the Lisbon Strategy. Is it, however, really that important to have access to vast amounts of cohesion funds, taking into account the way these are transformed into investments? By applying for giant projects in the field of infrastructure which demand huge amounts of national co-financing (and are accompanied by huge corruption) during construction and demand huge amount of public money later on as the cost of maintenance is to be financed entirely from the national budget? Would not be much more effective opting for some modernisation in the field of mentality and knowledge too, rather than exclusively in the field of material infrastructure? In this way, Hungary could maintain the qualified labour which is today running away from the country and looking for well-paid jobs abroad. It would also be possible to restore the status of teachers in order to raise the quality of education with its long-term consequences on both the economy and society.

<u>Answer of the Hungarian Government</u>:

Budapest is of the opinion that the existing policies – like Cohesion Policy and CAP – contribute significantly to the above mentioned four key policy objectives, hence they should be kept. These policies are able to speed up the modernisation of the Hungarian economy and the process of catching-up to the average EU level of standard of living.

In order to corroborate this rather categorical statement, further details praising the Cohesion Policy were unveiled in the Hungarian paper. By the latter, Cohesion Policy boosts competitiveness by:

- promoting employment,
- eliminating bottlenecks in infrastructure,
- supporting enterprises, and
- facilitating intra-Community trade.

Futhermore, regarding the important reforms implemented in the 2007-2013 period, the impact of which cannot yet be fully assessed, at this point there is no need for a major reform.

Criticism:

I think there is not enough evidence available to prove that the current Cohesion Policy promotes employment in Hungary. The utmost one can say is that if it has any effect at all, this should be insignificant.

As for the bottlenecks, there are and always will be bottlenecks in a national infrastructure system. It is especially true for transport infrastructure: if one bottleneck is eliminated another may emerge. One thing is sure: for a country with topographically so barely fragmented landscape, Hungary has, for the last couple of years alone, been the scene of immense building operations. One has actually to go as far as the Alps to see such high viaducts and long tunnels as in the Great Plain Hungary.

There are also doubts whether enterprises, in general, can benefit from those immense projects financed through the Cohesion Policy. The most characteristic feature of all these big infrastructure projects is that they are usually undertaken by the same few big (mostly foreign) multinational companies as main contractors. Although multinationals cannot do without involving Hungarian small and medium-sized companies, these are involved at the lower levels of the supply chain where there is much less profit, if any. It has to be noticed, that the Danish faced the same problem some years ago and solved it by cutting the projects into smaller pieces before tendering them out; as a result, also smaller national companies of engineering, counselling and other services could take responsibility for whole parts of the would-be infrastructure.[3]

As far as the facilitating of intra-Community trade is concerned, there is an old doctrine: trade increase wealth and well-being. But, is there any limit to how far trade can go? Is it really the overwhelming majority of people whose wealth and well-being is increased by more and more trade or could there be a great number of losers as well? What if the losers are not happy with the fact that their loss is less important than the gain of the winners? Can trade have disastrous consequences on society and nature? As long as there are no clear and definite answers to all these questions, one cannot argue in favour of trade facilitation even if it is customary to do so in European circles.

[3] See: Somai, Miklós (2005): *Tulajdonviszonyok és versenyhelyzet a dán infrastruktúrában* (Property and Competition in Danish Infrastructure) – MTA VKI, Budapest (paper in Hungarian) http://www.vki.hu/somai_miklos.shtml#

Taking into account all the above, I cannot agree with the statement that no further reform is needed in the Cohesion Policy. There are new topics to be involved which could make this policy more efficient and even cheaper: if one wants to foster cohesion in the European Union, it demands much less money in the field of education and culture and could have much bigger impact in the long-run than if huge sums are spent on physical infrastructure.

Answer of the Hungarian government:

As CAP brings significant benefits and important public goods for EU citizens – by providing incentives for an environmentally sustainable agricultural production, securing safe and high-quality food, contributing to the preservation of the landscape and cultural heritage of rural areas, etc. –, it should remain the exclusive competence of the EU. Hungary opposes the possibility of 're-nationalisation' of the CAP which would lead to distortions in the functioning of the internal market. Existing distortions (e.g. those caused by the different level of direct payments in the 'old' and 'new' Member States) must be abolished, too.

Criticism:

It is not surprising that Hungary is against national co-financing of CAP direct payments, for it would be clearly one of the net losers of such a scenario. [See: Table 1] The introduction of an element of co-financing in the first pillar could, however, be seen as a halfway house between the two extreme visions: namely, maintaining of the status quo (Polish and Hungarian wish) on one hand and a total deregulation (British dream) on the other. So, this sort of re-nationalisation could serve as a basis for compromise regarding the future of the CAP. As differences in budgetary conditions of the member states to co-finance the CAP-aids from national budgets could cause several disturbances on the internal market, the partial re-nationalisation of support should be combined with a tightening of competition and state aid rules in order to ensure strict discipline in national agricultural support.

Answer of the Hungarian government:

As for the new challenges listed in the Commission's consultation paper, Hungary emphasizes the need for further integration in the field of:

- justice and home affairs,
- research and development,
- energy,
- environment and climate policy,
- common foreign and security policy, and
- migration.

While admitting that the need for answering new challenges might imply a greater role of the EU-budget in the above fields, the financing of these objectives, however, should not endanger the financing of the Cohesion Policy, including the financing of infrastructure development. "*From the Hungarian point of view it is very important that the Cohesion Policy should not be a victim of such a development.*"[4]

Criticism:

It is time to reconsider what one thinks in Hungary about infrastructure development. It should mean much more than building of highways or other transport network, or the development of existing infrastructure, like capacity expansion, in the energy sector. In connection with environment and climate policy alone there are plenty of promising new directions to be explored. One example is the new conception of the Dutch about up-to-date water management. Within the context of the changing climate, they could be faced with so much water overflows, for which technical measures alone, such as raising dikes, would no longer be enough. In order to prevent floods, they must ensure that – in case of emergency – excess water of rivers can be routed into auxiliary channels and wetlands. This is less expensive and enhances flood protection.[5] Such a change in the mentality of the Hungarian bureaucracy , however, is very much missing.

Question:

*What principles should underpin the revenue side of the budget and how should these be translated in the own resources system? Is there any justification for maintaining correction or the compensatory mechanism?*

Answer of the Hungarian government:

The Hungarian government is more or less happy with the current own resources system (ORS) as it provides sufficient and stable revenues to finance the common budget. Budapest criticizes the VAT-based resource, as being complicated and lacking transparency, and the correction mechanisms making the burden sharing among Member States degressive. Consequently, Hungary opts for a system resting on two pillars: the Gross National Income (GNI) resource and the traditional own resources (TOR), and rejects any correction mechanisms to tackle budgetary imbalances. In addition, Hungary wants to maintain unanimity in decision making on ORS and supports the introduction of a genuine own resource from 2020 at the earliest.

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[4] See: Szemlér (2008)

[5] Government of the Netherlands (2010): *Water and Safety, Flood Protection Policy* – Ministry of Transport, Public Works and Water Management of the Netherlands [Internet] Available from: < http://www.verkeerenwaterstaat.nl/english/topics/water/water_and_safety/waterensafety.aspx> [Accessed 07 March 2010]

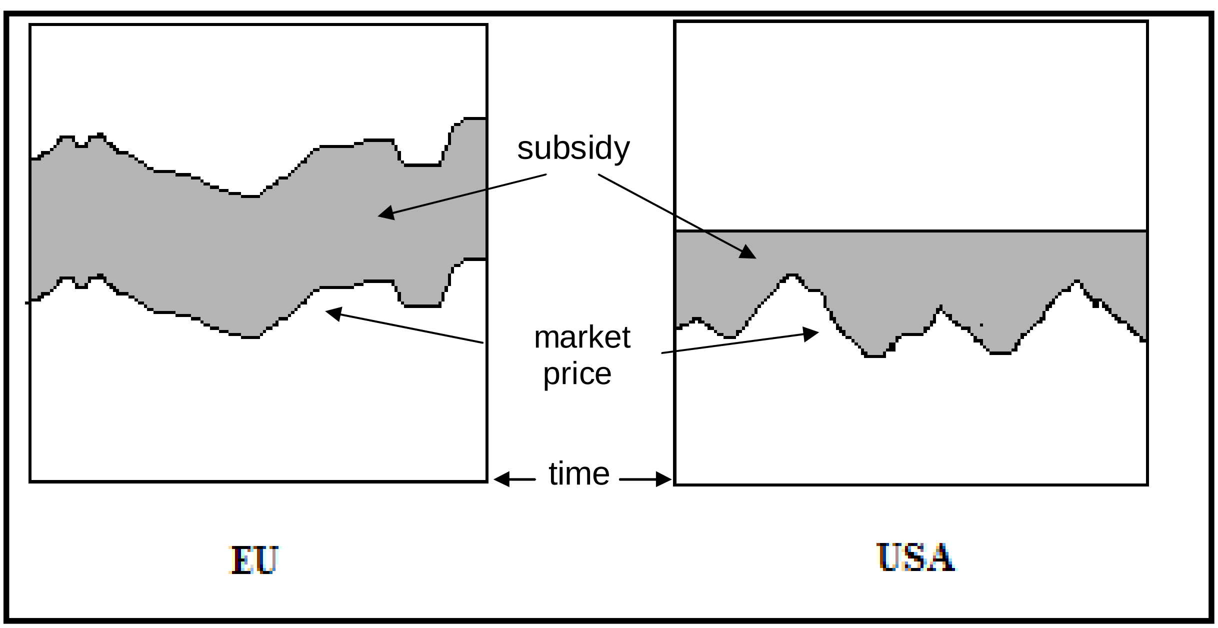
Criticism:

Departing from a purely logical approach, one can find some contradiction between rejecting the correction mechanism and hanging on to unanimity in decision making. As far as unanimity is the rule of decision making on ORS – the contribution to the financing of the British rebate being officially part of the ORS – the UK will have a veto concerning its own rebate.

Also, opting for an even bigger role of the GNI-based resource can contradict to blaming the net balance approach of the Member States. [See: in first part of this paper] Especially, if Hungary wants to keep the level of subsidies coming from the Cohesion Policy and the CAP beyond 2013. Practically, it means that Hungary calls for solidarity both on the revenue and the expenditure side of the budget. What else is this, if not a "net balance approach"?

**Figure 1**

Agricultural policy in




(very schematic illustration of the systems)

**Table 1 Impact of different level of co-financing of DPs on net budgetary position of the EU Member States during the financial perspectives for 2007-2013 (€ Mn/year)**

| EU-members | 20% co-financing | 35% co-financing | 50% co-financing | EU-members |
|---|---|---|---|---|
| Poland | -399.2 | -698.6 | -998.0 | Poland |
| France | -295.2 | -516.6 | -738.1 | France |
| Greece | -287.9 | -503.8 | -719.7 | Greece |
| Spain | -198.4 | -347.3 | -496.2 | Spain |
| Hungary | -194.6 | -340.5 | -486.5 | Hungary |
| Ireland | -147.3 | -257.8 | -368.3 | Ireland |
| Czech Rep. | -95.3 | -166.8 | -238.3 | Czech Rep. |
| Lithuania | -58.7 | -102.8 | -146.8 | Lithuania |
| Slovakia | -43.1 | -75.5 | -107.9 | Slovakia |
| … | … | … | … | … |
| … | … | … | … | … |
| … | … | … | … | … |
| Austria | 39.8 | 69.7 | 99.5 | Austria |
| Sweden | 70.4 | 123.2 | 175.9 | Sweden |
| Belgium | 231.4 | 405.0 | 578.6 | Belgium |
| UK | 248.2 | 434.2 | 620.3 | UK |
| Italy | 266.6 | 466.6 | 666.5 | Italy |
| Netherlands | 337.6 | 590.8 | 844.0 | Netherlands |
| Germany | 558.5 | 977.4 | 1,396.2 | Germany |

Source: own calculations based on Commission Budget Report 2006 and Health Check of May 2008

# From damage limitation to red lines: Slovak position to the reform of the EU budget

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Ongoing discussion on the reform of the EU budget reflects the long-term trends, shaped by general direction of the European integration (most notably, its progressive enlargement into new policy areas and deepening, creating pressure for larger financial resources), and key actors´ preferences and consequent decisions around a number of key issues (system of revenue-raising, spending priorities, winners and losers). This brief study sketches the debate on the future of the EU budget and provides an overview of the Slovak position, with short explanation on the important factors, and actors.

Since 1988 the structure of the EU budgets is decided on multi-annual basis. Those multi-annual financial perspectives were designed to avoid difficult annual negotiations, which would have become unmanageable in the more complex environment of an enlarging Community, with wider and more complex tasks. Naturally, negotiations on those package deals became some of the most important "political battles" in the EC / EU arena.

The importance of the EU budget could not be measured strictly on economic terms. We could argue that its macroeconomic importance is rather small: its expenditures represent only around 1% of the EU´s GNI, and it is the equivalent of only 2-4 percent of the combined national state budgets. Still, it plays an important role in the consolidation of the European integration and political dynamic of the process. Its importance was summarised by Laffan and Linder[1] as following:

- The search of an autonomous source of public finance was critical in building a Community that went beyond a traditional international organisation.
- Budgetary issues are entangled with debates about the role and competence of individual EU institutions and the balance between the European and the national level of governance.

[1] Brigid Laffan, Johannes Lindner: The Budget. Who Gets What, When and How? In: Helen Wallace, William Wallace, and Mark A. Pollack (eds.): Policy-Making in the European Union. Oxford University Press 2005, p. 192

- Visible budgetary flows to member states allow easy calculation of "winners" and "losers", which connects EU budgetary politics stronger to national political debates.
- Questions about the purpose of the budget and principles that govern its spending are linked to wider discussions about the nature of the EU and its evolution as a policy.

Later in the text we will argue that this could lead to contradictory national positions on budgetary issues, which have their roots in the fact, that the different actors that play important role in forming the national positions assign different weights to these reasons. However, in NMCs the strength of state bureaucracies over the ministries involved in preference formation on EU policy leads to more conciliatory outputs.

Political promise to reform the EU budget was a part of the financial framework deal in 2005.[2] Several controversial discussions (on CAP spending, future of cohesion policy, British rebate, etc.) have been thus postponed till 2007-2008, when according to the Commission!s proposal a wide debate should have started.

The EC presented its blueprint in September 2007. In April 2008 it has opened the official public consultation process, which was closed in June 2008. Commission has called the process a "success"; numerous consultations were received from public bodies, national governments and EU institutions, private sector, NGOs, academia, etc.[3]

To some extent, discussion about the future of the EU budget was overshadowed by other large European issues, which at the same time changed the external framework – most notably the difficulties of the ratification of the Lisbon Treaty (which prevented the completion of the original EC´s plan to close the budget reform until mid-2009, i.e. during the "Barroso-I" mandate), and global economic crisis. Several factors shape the current discussion:

- Critique of the CAP spending is mounting. Even if the objections are coming from different directions – most notably liberal economic, environmental, and developmental – they strengthen voices calling for more liberal approach[4]. Coupled with a growing importance of new policy priorities discussed later, arguments for substantial CAP reform

[2] See for example Sebastian Dullien, Daniela Schwartzer: Bringing Macroeconomics into the EU Budget Debate: Why and How? In: JCMS 2009 Volume 47. Number 1. pp. 153–174, or Iain Begg: The 2008/9 EU Budget Review. EU-Consent EU-Budget Working Paper No. 3. March 2007. Available at http://www.eu-consent.net/library/papers/EU-Budget_wp3.pdf

[3] All contributions are listed on http://ec.europa.eu/budget/reform/issues/read_en.htm.

[4] On importance of liberal-economic (neoliberal) arguments in the discussion on CAP see for example Clive Potter, Mark Tilzey: Agricultural policy discourses in the European post-Fordist transition: neoliberalism, neomercantilism and multifunctionality. In: Progress in Human Geography, Vol. 29, No. 5, 581-600 (2005)

are changing the historically inherited structure of the EU budget spending.

- The enlargements in 2004 and 2007 increased imbalance between the "winners" and "losers" in terms of the contribution-benefit ratio. Economic and social problems in various old-member states have made this issue politically sensitive. A pressure from large contributors to cut spending and balance contributions and benefits was evident already in 2005, and with social and economic pressures exacerbated by the economic crisis they appeared with new strength also in the current negotiations, even if often hidden in the clout of the discussion on "budgetary priorities".[5]

- Interrelated discussions on the EU budget reform, and the future of the EU Cohesion policy, show scepticism over the actual results of the regional cohesion policy on part of some large contributors, as well as in some parts of the European Commission.[6]

- The last few years have brought to the fore a number of new EU priorities in the area of energy, environmental protection, justice and home affairs, or external relations. These new priorities, pushed forward by the EU´s international obligations, new economic and political realities, or its own initiatives create pressure on the EU resources.[7] A discussion of redistribution vs. public goods spending correlates to a large extent with the one on the distribution of net financial burdens.

- Last but not least, the discussion on the EU budget resources is still ongoing, with arguments for the reform of the budgetary resources pushed forward for both administrative and political reasons.[8]

Based on this and the analysis of principal actors´ contributions to the public consultation of the Commission´s blueprint, we could argue that the

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[5] On conflicts among member states regarding the distribution of net financial burdens, and their impacts on the EU budget structure, see for example Angel de la Fuente, Rafael Doménech, Vasja Rant: Addressing the Net Balances Problem as a Prerequisite for EU Budget Reform: A Proposal. In: CESifo Economic Studies, June 2009

[6] See for example Willem Molle: European Cohesion Policy. Routledge 2007. Opposite argument that the Cohesion policy is overall effective and cost-efficient, could be found for example in: Sascha O. Becker, Peter H. Egger, Maximilian von Ehrlich, Robert Fenge: Going NUTS: The Effect of EU Structural Funds on Regional Performance. CESIFO WORKING PAPER NO. 2495, December 2008. Available at http://www.ifo.de/pls/guestci/download/CESifo%20Working%20Papers%202008/CESifo%20Working%20Papers%20December%202008%20/cesifo1_wp2495.pdf

[7] See Gabriele Cipriani: Rethinking the EU budget: three unavoidable reforms. Centre for European Policy Studies, 2007, pp. 136-138. On the similar note: EU budget – an institutional view. Public Finance and Management Volume 9, Number 4, 2009, pp. 536-579

[8] See for example Gabriele Cipriani: Rethinking the EU budget: three unavoidable reforms. Centre for European Policy Studies, 2007, pp. 42-65.

main battles of the negotiations of the next financial perspective will be the following:

- Spending ceilings, where net contributors and net beneficiaries form two clearly distinguishable groups. Current economic climate will strengthen voices calling for an "austerity" budget.

- Redistribution versus "public goods" spending discussion will be reflected in the controversy of cohesion policy vs. new priorities (innovation and research, energy and climate, external relations) spending. Here the opposing camps are less clearly delimitated and coalitions may change depending on the exact balance among allocations to different new priorities. The result will be influenced also by the outcomes of the debate on the future of the cohesion policy, notably by the answers of two principal questions: Should we refocus from regional cohesion to social and economic cohesion? Should we change approach of the policy, from regional to national one?

- Strongly interrelated with the previous one, and having its own dynamics, is the battle over the size and structure of the CAP spending. The trend of the lowering importance of CAP in the EU budget could be only slowed down by substantial reform of the agricultural policy itself, even though France is deliberately trying to counter this trend by creating a more coherent group of "CAP defenders". The meeting of 22 countries organised by Paris in December 2009, did not address the most important issue of the size of the CAP budget.[9]

- Correction mechanisms (concretely the British rebate) have featured high on the agenda of the last financial perspective negotiations in 2005, which might have been surprising for observers, who have expected much stronger alliance between the UK and NMCs. The pressure to abolish British rebate will be even stronger now, even if the UK might be headed by a Prime Minister defending the national "red lines" even more assertively than the last time. A realistic strategy of the UK government could only expect that it would trade a substantial concession on this issue by victory in other important areas (an obvious example would be the capping of CAP spending).

- Hard battle might be fought over the budget resources based on GNP, around the "contributive capacity" principle.

The outcomes of these budgetary battles might well confirm the major historical trends in the development of the EU budgets: a move from "fiscal

[9] See for example http://www.euractiv.sk/ekonomika-a-euro/clanok/francuzsko-vola-po-ambicioznej-polnohospodarskej-politike-014147

federalism" of the 1970s (based on the assumption that sizeable financial resources are essential to integration of policies) to more "regulatory approach" of the 1980s and later (where the public power in the EU rests more on the regulatory authority; and a gradual shift from the "de Gaulle budgets" through redistributive "Delors budgets" to the distributive "Barroso budges" (especially Barroso II) focused increasingly more on areas with "European added value".[10]

These general trends have a necessary effect on the development of the Slovak official position to the reform of the EU budget, but their concrete influence is shaped by specific factors. First of all, Slovakia is a large net beneficiary of the EU budget. As a relatively less developed country in terms of GDP per capita, it would clearly benefit from prevalence of the "solidarity principle" in spending and "contributive capacity" principle in financing the EU budget. Large regional disparities between Bratislava (with per capita GDP slightly above the EU average and other regions, with remarkably weaker positions) and its importance in the internal political debates mean that Slovak governments will always have interest in keeping "territorial cohesion" high on the EU agenda, with strong emphasis on the national approach (support going to "less developed countries", not "less developed regions").

Interest in "redistributive" EU spending is coupled with relatively weak capacity of Slovak organisations and institutions to participate in large transnational projects, especially those where the money are allocated predominantly on the "excellence" principle. In any EU spending structure build around "new challenges", Slovakia would be left worse off than in the current model.

Relatively "safe" incomes from the EU Cohesion and Structural funds have developed a habit among political elites, whereby the European funds became not supplementary, but principal source of financing some "non-mandatory" but politically attractive areas, which creates extra reasons for preservation of current structures and regulations of the cohesion policy, and its share on the EU budget. An example that speaks for itself is the Slovak national action plan for the Lisbon Strategy developed in 2004/2005 and partially revised under the new government in 2008. Rhetorically, the Slovak governments have thrown their full weight behind the calls to substantially increased public support in areas, which were considered necessary for building a globally competitive, knowledge-based economy (in the Slovak case these have added extra gravity by the fact that the Slovak Republic was the worst OECD member in terms of investment in research,

[10] Brigid Laffan, Johannes Lindner: The Budget. Who Gets What, When and How? In: Helen Wallace, William Wallace, and Mark A. Pollack (eds.): Policy-Making in the European Union. Oxford University Press 2005, pp. 197-208.

development and science as a percentage of GDP). But in practice these words were not matched by deeds (and more importantly, resources). In fact, strategic policy documents were explicitly saying that those "priorities" should be financed predominantly from EU funds and programs.[11]

Last but not least, principal Slovak policy actors show strong suspicion towards any European initiative that intervenes in the tax policy area (be it the "tax harmonisation" or introduction of the EU tax), which influences Slovak position in the discussion on EU budget revenues. This can be partly explained by predominant ideology in the national policy debates, but there is also a pragmatic reason – with EU budget financed from some "European tax", and less from resources based on GNI, the Slovak position of net beneficiary might be weakened.

On the level of policy actors, discussion on the national position seemed to be dominated by the bureaucrats on key ministries – the Ministry of Finance played the coordinating role, but was seconded by the Ministry of Foreign Affairs, with important role played by the Permanent Representation in Brussels.[12] Analysis of the consultation process and author´s personal observations and interviews with insiders seem to support more general observation on important role played by the state bureaucracies in the formulation of national positions on EU issues in NMCs, noted by other scholars.[13]

Political parties or individual politicians in Slovakia did not influence this discussion with more elaborated inputs. Their publicly presented positions remained on a more general level, when they argued for a need of "European solidarity", but at the same time objected any "tax harmonisation" in the EU.

Other interest groups played a relatively minor role. Groups that tend to be highly visible and active in other member countries (such as farmers, trade unions) are partly generally less organised and powerful in Slovakia, and were not interested and directly involved in the discussion. Wider farmers´ interests were reflected in the original proposal from the Ministry of Finance and were partly reflected in the comments from the Ministry of Regional

[11] National Reform Programmes, including the Slovak one, are listed at the Commission´s website: http://ec.europa.eu/growthandjobs/documentation/index_en.htm#national

[12] Summary of the outcomes from the consultation procedure available on http://www.rokovania.sk/appl/material.nsf/0/F7D4E39823F0ADBEC125740B004A75A1/$FILE/Zdroj.html

[13] Issue was discussed at length on the workshop „Preference formation in the new EU member states", organised in Bratislava by the Department of Political Science, Comenius University Bratislava, Slovakia, on 3.-5. December 2009. Researchers from various NMCs have come to similar conclusions. Presentations will be published in summer 2010.

Development (most importantly the need to level playing field for farmers from "new" and "old" member states in terms of direct payments).[14]

As a result of strongly de-politicised and bureaucracy/expert-dominated debate, the Slovak position on the reform of the EU budget could be characterised as "conciliatory". The document was approved by the government on the 26th March 2008 and subsequently sent to the Commission.[15] From the presented national preferences, the following could be selected as the most important:

- General position on the reform of the EU budget: the Slovak Republic supports the reform in general, but it should not touch current financial perspective and could affect only budgets after 2013.

- Principles governing EU budget: Slovakia calls for "balanced" consideration of principles, and puts emphasis on the solidarity principle.

- Size of the budget: no position explicitly mentioned in the summary, but general text mentions the need to keep the budget size at least on the current level.

- New priorities: Slovakia gives general support for increase of resources for the new policy areas (JHA, external policies, Lisbon reforms, climate and energy policies) and it tries to identify here specific national interests (energy security, bio-energy, biodiversity, hydro-energy, protection of external borders).

- CAP: No position on the size of CAP spending is explicitly mentioned, but the document uses arguments for CAP reform based on liberal economic approach (increase of competitiveness of European agriculture, provision of adequate market infrastructure, etc). Specific national demands in this and related areas include:

    - need to strengthen rural development given its important role in combating regional disparities and strengthening the social cohesion,

    - minimal (or none) national co-financing in agricultural policy, and

    - calls for creating level playing field for farmers from "old" and "new" member states (relates to pre-accession agreement on

[14] See the summary of consultation procedure on http://www.rokovania.sk/appl/material.nsf/0/F7D4E39823F0ADBEC125740B004A75A1/$FILE/Zdroj.html

[15] The original document could be found on http://www.rokovania.sk/appl/material.nsf/0/DD72F826E62C9858C125740B004A71E8/$FILE/Zdroj.html (in Slovak), list of contributions to consultation process on the Commission´s website includes also national positions in English – see http://ec.europa.eu/budget/reform/issues/read_en.htm.

only gradual increase of CAP direct payments to farmers in NMCs to the levels received by farmers in "old" members).

- Cohesion policy: The Slovak government states its readiness to discuss "concrete measures" of the policy, but underlines its overall importance and insists on preservation of at least 35% share on overall spending. At the same time it prefers "national principle" (money going to poorer countries, not poorer regions).

- Compensation mechanisms: The position strongly calls for abolition of all such mechanisms, without directly mentioning the British rebate.

- Administrative costs: Slovakia supports stabilisation, or slight decrease of administrative mechanisms and calls for measures securing more efficient use of capacities and resources.

- Budget revenues:

    - o Simplification of the "own resources" system, with emphasis on GNI-based resource and traditional own resources, while at the same time

    - o abolition of the VAT-based resource (arguing with its "administrative difficulty"), and

    - o objectives against any new tax-based resource, arguing that it would most probably necessitate "large harmonisation of the tax systems in the EU, which currently seems to be hardly feasible" (at the same time the document states that no concrete proposals from the EC are known and when they appear "they would necessitate a detailed analysis from the member states, while it will also be a politically sensitive topic").[16]

Finally, these preferences could be summarised into three overlapping groups according to their primary aim:

- Damage limitation: In some important areas the Slovak government realises that the outcome of the discussion on the budgetary reform will not conform its interests / expectations. Therefore it tries to limit the political damage either by preparing ground for future concessions, or stating its position in a very general way. Most notably this is the case of the size of future EU budget, principles governing its spending, and the position (and share) of the cohesion policy (in this respect – readiness to discuss "concrete measures").

[16] As we argue below, in this respect it is interesting to observe that the Slovak government chose to argue against tax-based resources not with its own specified objectives and reservations, but with the assumption that they would be politically unfeasible due to objections from other member countries.

Even though these areas touch upon potentially politically sensitive issue of the Slovak position as relatively large net beneficiary, state bureaucracy managed to keep the discussion on the "technical" level, which would allow concessions and (in better case) trade-offs in areas, over which Slovakia will have rather limited influence in the negotiations.

- Following larger trends: In some cases, the government decided to support explicitly larger European trends, arguing largely with "common interests". This includes areas which are supposed to be interest-neutral (cuts in administrative costs) or cases, when general support of (more-or-less) consensual position offers opportunity to specify some partial national interests (CAP reform, new policy priorities, etc).

- Tentative priorities: The document tries to identify cases, where Slovakia might profit from larger European trends, or find some opportunities in changes that will be generally inconvenient. Thus, it enumerates partial areas where Slovakia has some potential to capitalise on increased support for "new priorities", such as energy security, bio-energy, protection of external borders, etc.

- Red lines: In some cases, the Slovak government has decided to state its interest clearly. Typically, besides the interest of securing at least 35% share of the Cohesion policy on future spending, their concern is about the revenue side of the budget – emphasis on GNI-based resource, abolition of VAT-based one, and strong objectives against any tax-based resource. However, the fact that the national position is not arguing with any specific Slovak objectives to such measure, but only using reference to its assumed "political impassibility" might suggest that even this may not constitute a "no go" area.