What Kind of European Budget for 2013?

Means and Policies of an Enlarged Union

Edited by Maxime LEFEBVRE

With Nicolas-Jean BREHON, Patrice CARDOT,
Stefan COLLIGNON, Jacques LE CACHEUX,
Magdalena WERPACHOWSKA and Hugo ZSOLT de SOUSA

The Institut français des relations internationales (Ifri) the main French research centre and forum for debate on the major international political and economic issues. Headed by Thierry de Montbrial since its founding in 1979, Ifri is a non-profit organization.

The Centre des études européennes de Strasbourg (CEES) is under Public State and State reform supervision. It has a vocation for teaching all publics and for encourage studies and research which are a matter for European Union and Europe Council. The CEES plays a part too in administrative European cooperation.

This study, realized in partnership with the CEES, has been led by a task force headed by Maxime Lefebvre, in charge of the European Affairs at Ifri. The opinions expressed in this text are the responsibility of the authors alone. The conclusive abstract reflects the collective approach of the task force.

All rights reserved– Ifri – Paris, 2005
Institut français des relations internationales
27, rue de la Procession – 75740 Paris Cedex 15 – France
Tél.: 33 0(1) 40 61 60 00 – Fax: 33 0(1) 40 61 60 60
E-mail: ifri@ifri.org – Website: www.ifri.org

Contents

Abstract 3

Foreword 4

Concluding Summary 6

Part One

THE EUROPEAN BUDGET AT THE TEST OF ENLARGEMENT **13**
Maxime Lefebvre

Part Two

WHICH FUTURE FOR COMMON POLICIES? **46**

Future of the EU Budget and Financing of Common Policies **47**
Jacques Le Cacheux

The Impact of Regional Funds on Iberian Economies **60**
Hugo Zsolt de Sousa

Regional and Cohesion Policy after Enlargement **73**
Maxime Lefebvre and Magdalena Werpachowska

Towards a European Budget Dedicated to Security and Defense **87**
Patrice Cardot

Part Three

EUROPEAN BUDGET AND POLITICAL DEEPENING OF EUROPE **101**

Fiscal Federalism in Euroland **102**
Stefan Collignon

European Tax **116**
Nicolas-Jean Brehon

Part Four

THREE ALTERNATIVE SCENARIOS FOR THE EUROPEAN BUDGET IN 2013 **133**
Maxime Lefebvre

Abstract

On May, 1st, 2004, the European Union welcomed ten new member states. This enlargement, unprecedented considering its scale and its consequences, is both a chance and a challenge for the building of the European Union. It leads the Union to question its future and its very signification: what is from now on the common project driving the member states, and what are the means they are willing *to put to the task*?

The *institutional means* have been the subject of a lengthy negotiation that ended with the adoption of a constitutional treaty. Another essential negotiation is now under way: the one about the *financial means* of the European Union (the "financial perspectives 2007-2013"). The European budget is of a major import: it conditions the level of the ambitions of the common policies the enlarged European Union wants to implement and the solidarity it is willing to show to both its members and the rest of the world.

This study, led by the Centre des études européennes de Strasbourg (CESS) in partnership with the Institut français des relations internationales (Ifri), was carried out by a working party co-ordinated by Maxime Lefebvre, who was in charge with the European Affairs at Ifri. It analyses the stakes in the budgetary negotiation, offers news reflections on the future of common policies and on the deepening of the European Union building policy, and develops various scenarios for the future European budget in 2013.

Foreword

The May, 1st 2004 saw the enlargement of the European Union to ten new Member States. This enlargement, unprecedented both by its sheer size and consequences, represents an exceptional occasion, but also a challenge, to the process of European construction. It obliges the European Union to question its future and the meaning of its very existence: what shall be the common project that shall henceforth be the driving force behind all Member State's activities and what means shall be put into place to achieve this goal?

"Institutional means" have been the subject of long negotiations that have led to the adoption of a constitutional treaty.

However, another highly important negotiation also enters the equation i.e. the financial means of the European Union for the seven years to come. Said otherwise in European terminology, the "financial perspectives for the period 2007-2013".

This extremely technical negotiation also represents a major political issue. Indeed, large sums of money (totaling 1.000 billion Euros for the whole period) are at stake in these negotiations. Still more important, this financing would determine the scope and strength of an enlarged European Union's common policies. Through its annual budgets, the European Union is called upon to define its priorities and projects. It is brought to make a decision on the degree of solidarity it wishes to express both towards its own Member States and to the outside world.

It is within this context that the Centre des Etudes Européennes de Strasbourg (CEES) and the Institut français des relations internationales (Ifri) decided to join their efforts in making a contribution that will both be useful to the negotiators and explore a certain number of operational choices.

The following study brings together a number of unique characteristics:

– *Collective reflection*: a working group, coordinated by Ifri, regularly met from January through to May 2004 and consulted numerous personalities involved in the administration,

the European Commission and the academic world; indeed, the contributions of the members of this group are solely the responsibility of the author, but as could be seen in the concluding summary of the present study, these contributions have all been the fruits of collective reflection;

– *The European dimension*: four European countries have been represented in this working group and the bid to define an "European public good" has inspired all its members;

– *Pluridisciplinarity*: the authors, with backgrounds varying from research to public administration, have gone on to analyze the economic, technical and budgetary aspects of the subject, while at the same time integrating its political and diplomatic dimension (the importance of the European budget for the consolidation of democracy in European construction; the difficulties of a negotiation which shall be, above all, intergovernmental);

– *Contributing to the democratic debate*: it is of common belief that European construction is often technocratic and opaque; the publication of a series of reflections emanating from the public domain and aimed at explaining the major stakes involved in the next round of budgetary negotiations is indeed a welcome development;

– *Prospective and concrete orientation*: this study does not limit itself to analyzing the stakes involved in the negotiations or criticizing the current positions; rather, it focuses on unexplored issues, formulates recommendations, elaborates alternative scenarios and opens unto new horizons.

This study on the future of the European budget claims neither to offer a miraculous solution for the success of budgetary negotiation nor to define the best possible European budget. Indeed, if the recommendations and suggestions included herein could facilitate budgetary decision-making, enlighten public choice and give rise to debate, this book would have achieved its objective.

RALPH DASSA,
Director, CEES

MAXIME LEFEBVRE
Head of European Affairs, Ifri

Concluding Summary

While the European Union has recently undergone a historic enlargement to 25 Member States and further enlargements are yet to take place (Romania and Bulgaria from 2007), the negotiation of the forthcoming budgetary perspectives for 2007-2013 shall no doubt represent a crucial stage in the future of European construction.

1. The European budget, together with the common policies financed by it, has a profoundly integrative function. The MacDougall report of the 1970s foresaw the parallel integration of public finances with market integration and monetary union. It proposed the entire allocation of the defense function to Europe. This was to lead to an approximate European budget of 2% of the European Union’s GDP. The report also proceeded to envisage an evolution towards a “pre-federal” stage where the European budget would total up to 5 to 7% of its GDP.

Such an evolution seems hardly possible today. Despite monetary union, this evolution has barely seen any development. The European budget represents a mere 1% of the Union’s Gross national income (GNI). Moreover, six of the most important “net contributors” to the European budget (United Kingdom, Germany, France, the Netherlands, Austria and Sweden) are going into the negotiations of the forthcoming financial perspectives with the demand that this limit not be exceeded in the future.

The European budget is characterized by a form of inertia linked to the sedimentation of common policies put into place since the 1950s, to such an extent that the Sapir report referred to it as a “historical relic”. Today, there exists a great risk that a weak European budget would lead to the renationalization of common policies so painstakingly constructed through time. Furthermore, a weak budget would not offer the necessary means to strengthen policies with real “added value” to European action. The dynamics of European construction would then be shattered.

Still, the European Union is confronted – through its Eastern enlargement – to an unprecedented challenge of solidarity. The extension of the Union’s agricultural policy and its regional policy to new Member States shall put considerable strain on its budget while the

contributing countries of the West are simultaneously confronted with low growth rates and large public deficits. If Europe does not succeed in facing up to this challenge of solidarity, how indeed would she be able to emerge as a powerful actor in the international arena?

Negotiation on enlargement has helped contain budgetary drift for the period 2004-2006. But everything shall be started anew for the financial perspectives for 2007-2013, even though certain decisions already anticipate the result of the negotiation (especially the creation of a budgetary ceiling, in 2002, on agricultural market expenditure).

2. Three major issues should be taken into account when considering the future of the European budget: the volume and allocation of expenditure; the equity in sharing the financial burden; the link with the growth and stability pact.

– In February 2004, the European Commission presented its proposals for the financial perspectives for 2007-2013. It foresaw a budget attaining 1.15% of the Union's GNI in payment credits (against 1% in 2003). Its ceiling of 1.24% in engagement credits warps perception to a certain degree: it is the paid expenditure that shall determine the calculation of State contributions for a particular year, but committed expenditure most often leads to later payment.

The Commission's propositions seem to be going in the right direction. They foresee, by at least partially following the recommendations of the Sapir report of summer 2003, an increase in competitive expenditure (research, education, infrastructure, etc.) which should triple by 2013. In conformity to the Brussels agreement of 2002, agricultural market expenditure shall be limited and their relative share in the total budget should, as a result, decrease. Taking into consideration the increasing proportions of aid that shall be handed out to the farmers of new Member States, this shall also imply that the farmers of older Member States will receive less assistance. Finally, the Commission foresees a broad regional policy that shall ensure a significant effort of solidarity to assist new States in rapidly catching up with European standards, while at the same time continuing to assist other regions of the European Union.

– The problem of equity regarding the sharing of the burden between "rich" countries will no doubt be an important aspect of the negotiation. The logic of financial solidarity, which originally was one of the founding principles of the common agricultural policy, has been lost since the United Kingdom obtained, in 1984, a "cheque" to reduce its contribution. Since then, Germany has obtained a rebate on the financing of the British cheque (a "discount on a

discount"). In 1999, the share of the four major net contributors (Germany, Netherlands, Sweden and Austria) in financing the British cheque was reduced. As a result, France and Italy have today become the major contributors to this cheque.

The notion of "net balance" (*i.e.* the difference between a Member State's contribution to the European budget and what it receives through common policies) could be discussed through many angles – philosophical, economic and from an accounting point of view. However, this concept should be dealt with great care. Member State's interest in the financing of the European Union cannot be reduced to the mere size of its "net balance" and should also take into account other advantages gained through European construction. In spite of this, net balances still remain the main indicators of a State's interest in budgetary negotiation.

Our simulations imply that by 2013, several countries would find themselves to be, within the scenario of the European Commission, net contributors of around 0.6-0.8% of their GNI to the European budget. The United Kingdom shall remain, in the absence of any reform, the most important net contributor because of its weak return insofar as agricultural and regional policies are concerned. But holding on to its cheque would put it into an excessively advantageous situation since it is currently (as opposed to previously) a country whose per capita income largely exceeds the European average. In the current state of affairs, France seems to be the country that has been the most penalized by the British cheque.

If we were to replace the "British cheque" by a generalized correction mechanism, as intended by the European Commission, negative net balances could be leveled down at a compromised rate of 0.5-0.6% of the GNI of the major net contributors. Another possible option would be to just purely and simply ceil net balances to 0.5% of GNI and to reimburse any excess to the States. The principal drawback of such corrective mechanisms is they blur the political legibility of the Union's financing. The European budget would run the risk of becoming increasingly like a "bank account" where everyone tries to take back what he gives, rather than expressing a political identity, solidarity and the capacity of common action at a European level.

Still, the solidarity expressed in the European Union's regional policy is a necessity. The experience of "cohesion" countries (Ireland, Greece, Spain and Portugal) since 1988 has proved that structural assistance, as long as they are accompanied by good macroeconomic policies, could help States, and to a lesser extent regions, catch up with the rest. Given that the new Member States start off from a considerably lower level, it is important to maintain a strong regional policy. However, many questions could be raised on the desirable level of

budgetary solidarity (the distributive function of public finances), and on the utility in scattering credit all around instead of targeting those countries most in need of it.

– The question of solidarity and equity should be seen in the light of the economic theory on budgetary federalism, which has shown the importance in centralizing, at a federal level, all stability functions as well as the redistribution of public finances and simultaneously decentralizing the distributive function (financing of public goods).

In the absence of a federal European government, it is the stability pact that ensures macro-economic stabilization within the Economic and Monetary Union (EMU); but this pact leads to an increased risk of European deconstruction by giving priority to the fight against budgetary deficits instead of giving priority to efforts of redistribution to new Member States. It is indeed to a certain extent contradictory to request contributing countries to make a significant budgetary effort to finance the European Union but at the same time ask them to strictly adhere to the pact criteria that limit the level of public deficit to 3%.

For this reason it is important to integrate budgetary policies at both national and European level. The total budgetary position of the Euro zone could be defined at a central level while its distribution amongst Member States (who primarily ensure the distributive function) would be done by quotas and through the exchange of “deficit permits” so as to be able to face asymmetric shocks. Such an evolution should fit well with a strengthening of European political integration (definition of the global budgetary position by the Union through “co-decision” by the European Parliament and the European Council, at the request of the European Commission).

It is also important to define, at a European scale, the allocation of “European public goods” represented not merely by the management of the Economic and Monetary Union (interest rates, exchange rates, inflation monitoring, global budgetary position) but also by common policies such as agricultural policies, regional policies and foreign and defense policies. It would be logical to assume that a democratically voted European budget for the financing of such European public goods could indeed be financed by a European tax (combining various European fiscal resources, for example: customs tax, energy tax, VAT, corporate taxes). The advent of democracy in our national States was closely linked to consent regarding taxation. The setting up of a federal budgetary system goes hand in hand with the political and democratic deepening of European construction. All this is not incompatible with the management of public finances, given that the ceiling on proper resources could be held at or slightly above 1.24% of European GNI.

Proceeding further along the same lines, one cannot help but wonder if common European defense policy, currently undergoing massive transformation at both institutional and executive levels, does not present a unique opportunity. The creation of a true budgetary foundation for European defense could indeed help strengthen the integration of European means in matters of defense (especially in the field of research and arms procurement), strengthen the defense function of the European Union (essential tool for the management of crises and to assert Europe's role a stabilizer in the world), and to produce a "common" policy at the European level. Indeed, wouldn't the strengthening of the European Union's weight on the international arena, defense and the assertion of its identity vis-à-vis the rest of the world, together represent an ideal collective good?

3. Within this framework, three alternative scenarios to the Commission's proposals have been developed.

The *"conservative" scenario*, which today seems the most probable, given the current state of negotiations, is based on a budgetary constraint of 1% of the GNI and on the acquisition of common policies. It ensures maximum preservation of the common agricultural and regional policies with little or no alteration. However, this is not the best scenario since it would lead to the sacrifice of competitive expenditure, much needed for the viable economic future of Europe.

The *scenario "competitiveness-solidarity"*, also situated in the 1% GNI range, sacrifices a part of regional politics (objective 2, aimed at older Member States) in order to concentrate efforts on competitive expenditure and assistance to the most needy regions of the European Union (mainly to be found in new Member States, but also spanning some regions of older Member States, including those who will stop being eligible but who will benefit from transitional assistance – a statistical "phasing-out"). This scenario does not solve the problem of "net balances", and just as the previous scenario, shall call for a generalization of a corrective mechanism in substitution for the British cheque.

The *"European public goods" scenario* is a believer in the 1.15% GNI limit and creates a "defense fund" that shall mainly be managed by the European Defense Agency and that will enable, on the basis of the principle of additionality, the creation of a European security and defense policy (research, communizing external operation expenditure, development of common armament programs, etc.). According to this scenario, regional policy shall function at a lower scale but shall nevertheless continue to be of benefit to all regions of the European Union. The level of agricultural expenditure shall remain limited as in other scenarios.

The advantage of the "defense fund" is that it shall clearly be of benefit to the contributing countries *i.e.* United Kingdom, France and to a lesser extent Germany, who are the three countries paying the most for their – and by extension Europe's – defense. If we were to take into account the budgetary savings that shall be made in the defense budget of Member States thanks to the implementation of a "defense fund", the calculation of "consolidated net balances" in the "European public goods" scenario would lead to a relative convergence towards a rate of 0.4-0.5% GNI for the major contributing countries. Theoretically, this could lead to the suppression of the British cheque and the eventual implementation of a "European tax". The solidarity effort as regards poorer countries of the European Union shall not be very different to the preceding scenarios.

This last "European public goods" scenario is probably not the most realistic scenario for the forthcoming budgetary negotiations, it is however not the least promising insofar as the European Union's future is concerned. It highlights an alternative to the renationalization of common policies as well as an alternative to the British cheque. Without counting on the unrealistic increase of the Union's budget, it has the credit of enabling the Member States to overcome the challenges of enlargement through an increased level of integration and efficiency at the European level and draw up a common project with 25 members or more.

If we do not wish to have a negotiation that would get caught up in a "vicious circle" of mere accounts return, it is important to clear the path by combining a moderate increase in the Union's budget, with a strengthening of "European public goods", a better coordination of Euro zone budgetary policies, making net balance differences between rich countries relative, and the implementation of a democratically voted European tax. It is then that we could achieve success in this negotiation and lead the way to a "virtuous circle" comforting, rather than undermining, European construction.

Part One

The European Budget at the Test of Enlargement

The European Budget at the Test of Enlargement

MAXIME LEFEBVRE[1]

The European budget neared 100 billion Euros in 2003. This sum is both important in absolute value (it represents a third of the French State's budget) and weak in relative value (1% of the GNI[2] of the European Union at fifteen). The negotiation of the European budget is an important question since this negotiation conditions the degree of solidarity and common action within the EU. The question of the European budget cannot be dissociated from the question of Europe's political construction.

The European budget is determined, since 1988, by multi-annual "financial perspectives" that determine the ceiling on resources and expense categories for several years. The last financial perspectives were determined by the European Council of Berlin (March 1999) and span the years 2000-2006. The next financial perspectives shall deal with the years 2007-2013 and their negotiation amongst States should begin once the Commission has presented its proposals. It is the current Commission, whose term ends in November 2004 that will present its inter-institutional Commission-Council-Parliament proposals. But negotiations would rightly begin only under the next legislature.

Enlargement is quite unsurprisingly a major dimension of this negotiation. Through the integration of new, poorer Member States, the European Union will have to agree to an effort of solidarity and cohesion. But the process of catching up with old Member States can also be a formidable growth opportunity for the entire European economy. Already, back in 1999, the EU's then fifteen members had reserved an envelope for future Member States. This envelope was confirmed by the European Council of Copenhagen, in October 2002, in order to enable the financing of the enlargement for the period 2004-2006.

Beyond this point, the negotiation opens unto an almost blank page. Some studies, especially the "Sapir report" which was made public in July 2003, have been conducted and written by a group of economists, at the request of the Commission's president. The

[1] Maxime Lefebvre is the head of European Affairs at Ifri.
[2] Since 2002, the notion of "gross national income" (GNI) substitutes the notion of GNP in the calculation of resources pertaining to the European Union's budget.

Commission itself presented, in February 2004, a communication proposing a financial framework of 1.14% of the enlarged European Union's GNI for the period 2007-2013 (in payment credits). Based on this communication, the Commission hopes to present more precise legislative proposals next summer.

The negotiation would indeed be long and arduous. It is now up to the 25 Member States to seek the necessary compromise between solidarity (between rich and poor States), equity (between contributing States) and efficiency (in order to revive European growth and competitiveness).

1. The European Budget Before Enlargement

The European budget remains marked by its history, especially by the successive accumulation of various "proper resources" since 1970 (that make up for the absence of a European tax) and by the gradual definition of new common policies (the most important of which are agricultural and regional policies).

The budget of the European Communities went from 60 million ECUs in 1960 to 3.6 billion in 1970, 16.5 billion in 1980, 45.6 billion in 1990. The total payment credits in 2003 were at 98 billion Euros (100 billion Euros in commitment credit). In 2004, the first year of enlargement, the European budget project amounts to 100 billion Euros in payment credits (111 billion in commitment credits, engaged credits being able to be subject to later payments). However, all credits are not used, and as such, the execution of the European budget is, at the end of the day, inferior to what has been foreseen.

1.1. Resources

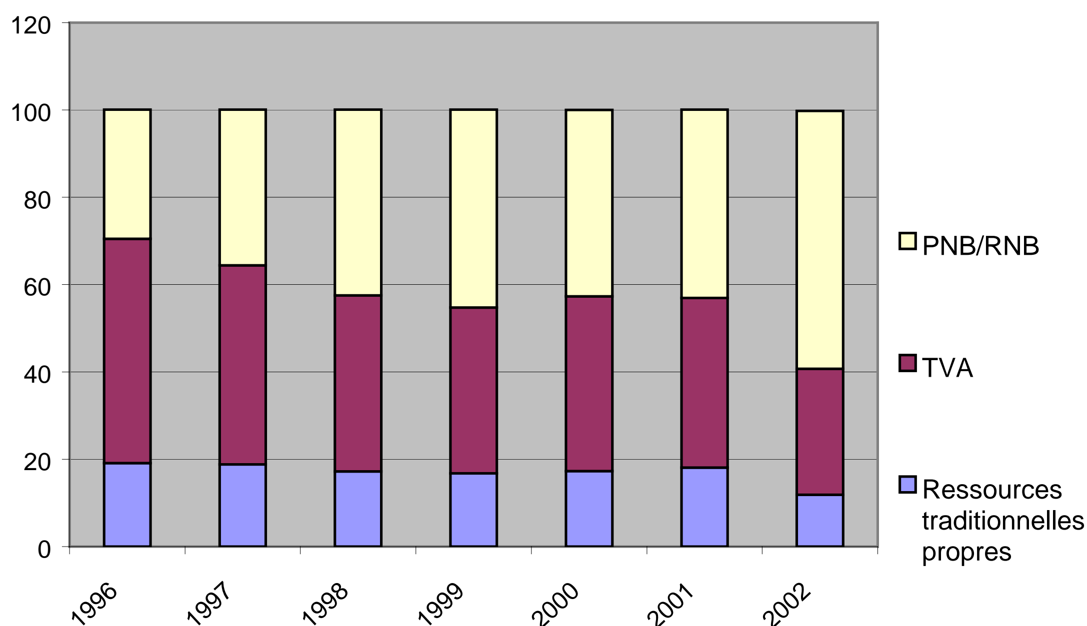
The European Union does not directly impose "proper resources". It is the States that pay them to the European budget. A Council decision, taken in 2000 and implemented in 2002, modified the regime of proper resources.

1. *"Traditional" proper resources* are linked to European policies: they include agricultural impositions, subscriptions on sugar, and customs rights on imports into the European Union. The Member States pay them to the European budget after a reduction corresponding to perception fees. This imposition increased from 10 to 25% with the new proper resources

decision, which in turn leads to a decrease in the relative share of traditional resources in the European budget.

Traditional resources formerly represented the major source of income for the European budget. Their share decreased to 12% in 2002.

Graph 1. Structure of Resources of the EU Budget, 1996-2002



2. The "*VAT resource*", introduced in 1979, is obtained through the application of a uniform rate to the VAT plate of each Member State. The VAT plate is evaluated in a uniform manner, but cannot exceed 50% of each Member State's GNI. The new proper resources decision foresees that the maximum appeal rate of the VAT resource move from 1% to 0.75% in 2002 and to 0.5% in 2004.

VAT income represented up to two thirds of the European budget around the mid 1980s, but it has today decreased to around 15%.

3. The "*GNP/GNI resource*" was introduced in 1988. It is obtained through the multiplication of the EU's GNI by a specific rate determined during budgetary procedure. The rate is fixed in such a manner so as to create a balance between the total expenditure for the year and the total income. The GNI resource is hence an equilibrium resource for the European

budget. Since it is divided between Member States according to their share in the European budget, it is the most equitably distributed resource insofar as Member States' wealth is concerned.

The GNI resource represented more than half of the European budget's resources in 2002. With the new proper resources decision, and from 2004 onwards, GNI resources would represent 70% of the EU's income.

In 1999, the ceiling for proper resources was fixed at 1.24% of the EU's GNI[3]. But this ceiling, which has not changed since 1988, is not a ceiling on expenditure. In reality, the "multi-annual financial perspectives" foresee a lower ceiling on expenditure that corresponds to around 1.08% of the EU's GNI for the period 2000-2006.

1.2. Expenditure

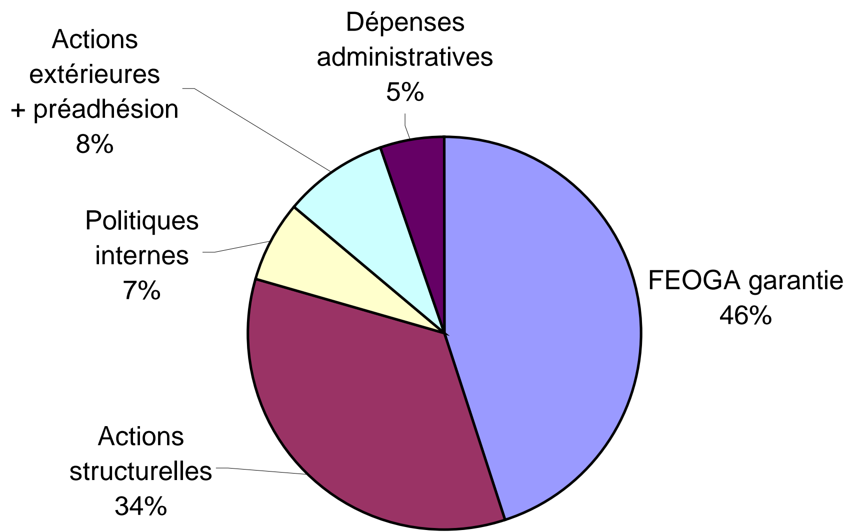
1. *Agricultural policy* represents nearly half of 2003's expenditure. Created in 1962, and modified several times thereafter, agricultural policy remains the most important common policy of the EU. It is the European Agriculture Guidance and Guarantee Fund (EAGGF or FEOGA as it is known by its French acronym), the "guaranteed" section, that manages the credits of the common agricultural policy.

The common agricultural policy is based on three principles: price unity, EU preference and financial solidarity. A part of common agricultural policy expenditure is market interventions: purchases to support prices and restitutions for export. Since 1992, "direct aid" paid to agricultural operations have largely taken over such market intervention. A "second pillar" was later added to the common agricultural policy in 1999: expenditure in the name of rural development, which represents 10% of the FEOGA's budget-guaranteed.

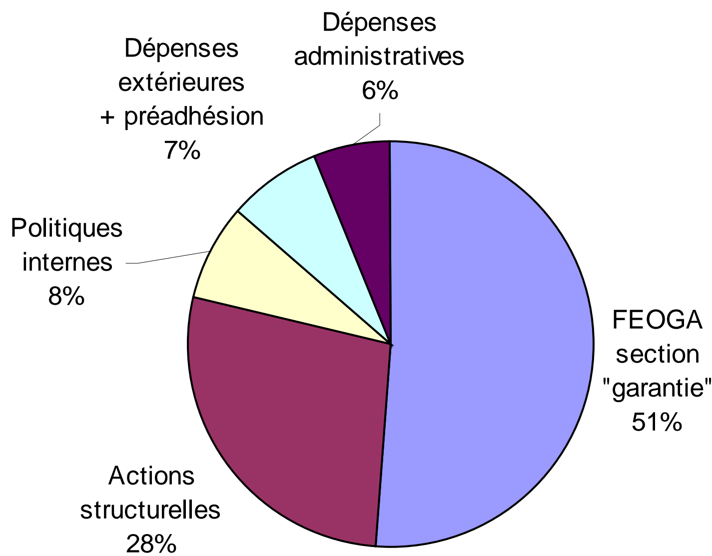
2. *Regional policy* represents a third of the EU's budget credits. This policy dates back to 1975 (creation of the European Fund for Regional Development), but has since undergone many changes. The credits doubled in 1988, following the accession of Mediterranean countries, and a "cohesion fund" was created in 1993. Regional policy played an important role in the development of the so-called "cohesion" countries (Ireland, Spain, Greece and Portugal).

[3] Since March 1st, 2002, date when decision 2000/597/CE of September 29, 2000 was implemented, the ceiling of proper resources should be expressed as a percentage of Gross national income (SEC

Graph 2. The Distribution of Commitment Credits in 2003 in %



Graph 3. Structure of the EU's Total Expenditure in 2002 in %



---

accounting norms 1995). This ceiling transformed into 1.24% of the EU's GNI while it was previously fixed at 1.27% of the EU's GNP/PNB (previous accounting norms).

Regional policy (also called "structural action" in the presentation of the EU's budget) is distributed through structural funds (FEOGA-orientation, European Fund for Regional Development, European Social Fund, Financial instrument for fisheries orientation) as well as through the "cohesion fund". Regional policy is essentially aimed at assisting the lesser developed countries of the EU, but the richer countries do also benefit from it.

Regional policy credits are distributed according to "objectives". The 2000-2006 agenda has defined three such objectives:

– *objective 1* concerns regions whose per capita GDP, calculated in purchasing power parity, is inferior to 75% of the European average; the credits of objective 1 are distributed through all of the structural funds and represent 71.3% of the total endowment of structural funds;
– *objective 2* concerns regions that are facing difficulty or that are undergoing transformation; the credits of objective 2 are distributed through the European Fund for Regional Development and the European Social Fund and represent 10% of the endowment of structural funds;
– *objective 3* concerns action in the field of education, training and employment in the regions that are not eligible for objective 1; the credits for objective 3, distributed through the European Social Fund, represent 11.6% of the endowment of structural funds.

The "Community initiatives" (a total of four: INTERREG for cross-border cooperation, URBAN for urban areas, LEADER+ for rural development, and EQUAL for access to the labor market) as well as the cohesion fund that solely benefit "cohesion" countries (*i.e.* those whose per capita GDP is inferior to 90% of the European average) should also be added to the above three objectives. The cohesion fund represents around 10% of regional policy credits. It uniquely benefits Spain, Portugal and Greece. Ireland lost its benefits during the half-way revision of the 2000-2006 agenda because it had considerably increased it per capita wealth during the past years.

3. Other *internal policies* barely represent 7% of the European budget's credits. They include, for example, the trans-European network program (transport, energy, communication) or research policy. These policies encourage growth and innovation.

4. *External action* and *pre-accession expenditure* together represent more than 8% of the credits. They include expenditure for development aid (even though the European Fund for Development has a separate budget), reconstruction aid, humanitarian aid, etc. Aid to the Balkans, for example, represents 1 billion Euros per year. Pre-accession expenditure

covered the 10 adhering countries until May 1st, 2004, and now only concern Bulgaria, Romania and Turkey.

5. Finally, *administrative expenditure*, required for the functioning of European institutions, represent slightly more than 5% of the credits of the European budget.

The European budget is expected to be well balanced. The European Union is neither permitted to have a budgetary deficit, nor could it have public debt. Yet, the budget that is carried out is always different to the projected budget. The European budget's income and expenditure are in reality inferior to the 1% European GNI level because of a general under-utilization of credits, especially in the field of regional policy.

For the year 2002, the sum of proper resources gathered by the EU increased to 78 billion Euros, to which another 17 billion Euros of other income (including the previous year's balance) should be added. The total paid out expenditure increased to 85 billion Euros. Throughout the past years, the European budget has systematically resulted in a large surplus, which decreases the call for contributions in the following year.

2. Equity and Solidarity in the European Union of Fifteen

Each Member State pays careful attention to the cost and the benefits that the European budget represents to him. The contributions are more or less proportional to the GNI of each country. Expenses primarily benefit countries with a strong agricultural base (mainly France and Spain) and/or countries that are being assisted in the name of regional policy (Spain, Germany, Portugal, Greece and Italy). Countries that do not benefit from sufficient return find themselves in the position of "net contributors". The calculation of net balances is however rather complicated: depending on the methodology used, significant differences could be registered between net positions of different Member States.

Moreover, a mere calculation of the return of each country over its contribution does not take all the other external effects of common policy into account. For example, regional policy credits lead to orders for firms in contributing countries: according to the Commission, 25% of the structural funds resulting from objective 1 lead to imports from other Member States. Administrative expenditure stimulates consumption in the country where such expenditure has been carried out, and later brings in fiscal income to the State in question.

More generally, one should not limit the benefits of participating in the European Union uniquely to budgetary flux since this would imply rejecting of the principle of solidarity which is at the heart of European construction and overshadowing the economic and political advantages gained through common action (growth brought through economic integration and the internal markets; the well-being and security generated by the implementation of an area of free circulation for European citizens and the creation of police and judicial cooperation at the European level; the EU's action in favor of stability and peace; etc.). A stronger, more united Europe that also espouses solidarity is in the interest of all. It is this, which has for example led Germany to make a significant budgetary effort in favor of the EU.

Only the question of net contributions now remains to be dealt with in the budgetary negotiation. Each State will, in spite of all its good intentions, seek to reduce the cost of its contribution to the European budget and maximize its benefits, even more so because the negotiation continues to be led by Member States and because the decision-making role of the European Parliament would eventually be established only if the Constitution is put into place.

2.1. The British Discount

Since 1984 (European Council of Fontainebleau), the British have received a "discount" on their contribution to the European budget.

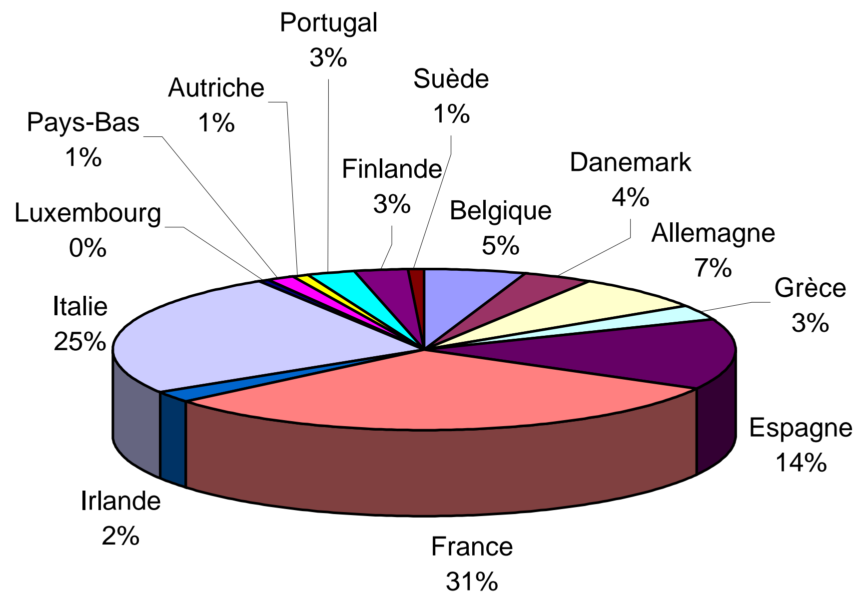
The British argument was that they were penalized by the common agricultural policy (because of a poorly developed agricultural sector and because of imports from the Commonwealth), and also penalized by the system of traditional proper resources (because of their port installations), and finally penalized by the system of the VAT resource (because their VAT plate is proportionally more important than that of other Member States in relation to their GNI).

The British thus obtained – and this has since been confirmed – a "rebate": every year, the United Kingdom is refunded two thirds of preceding the year's disequilibrium (*i.e.* the difference between its payments to the European budget and its return on the grounds of common policies, including administrative expenditure). The British correction is financed by the other Member States in proportion to their share in the EU's GNI.

Since 1984, the Germans have obtained a reduction of a third of their share in the financing of the British correction. This is due to their position as strong "net contributor" to the European budget.

In 1999, at the European Council of Berlin, the British obtained the confirmation of their correction, but the main net contributing States demanded a gesture from France and the other beneficiary States of the European budget. The share of Germany, Austria, Sweden and the Netherlands in financing the British correction was thereby reduced to a quarter of the normal amount. As a result, it is France and Italy who now together finance more than half of the British correction (which amounted to almost 5.5 billion Euros in 2003).

Graph 4. Participation in the Financing of the British Correction for 2002 (2003 budget)

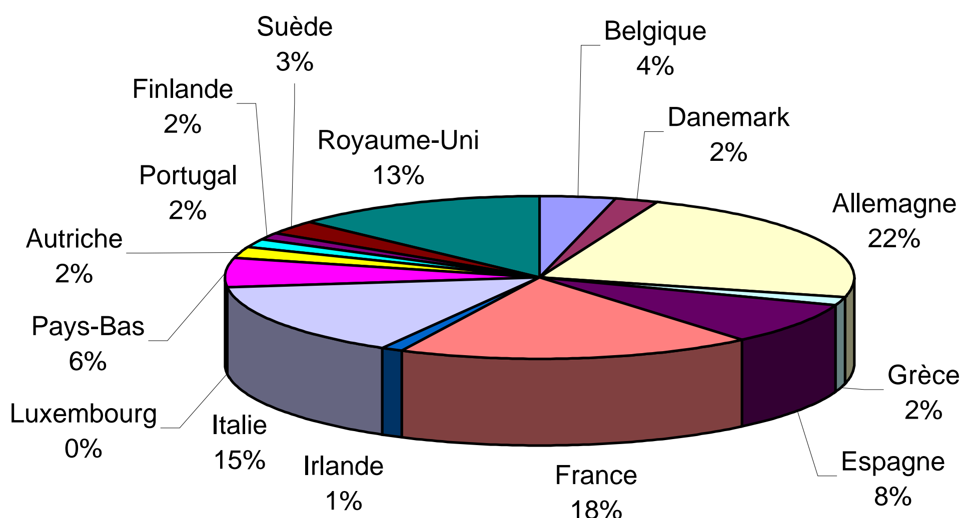


2.2. Net Balances

The difference between a State's contribution towards the European budget and the return it obtains from common policies makes up a State's "net balance". Each year the Commission publishes a report on "distributed operational expenditure", which enables the calculation of net balances. The expenditure that is not distributed is administrative and external expenditure. The report on distributed operational expenditure for 2002 was published in September 2003.

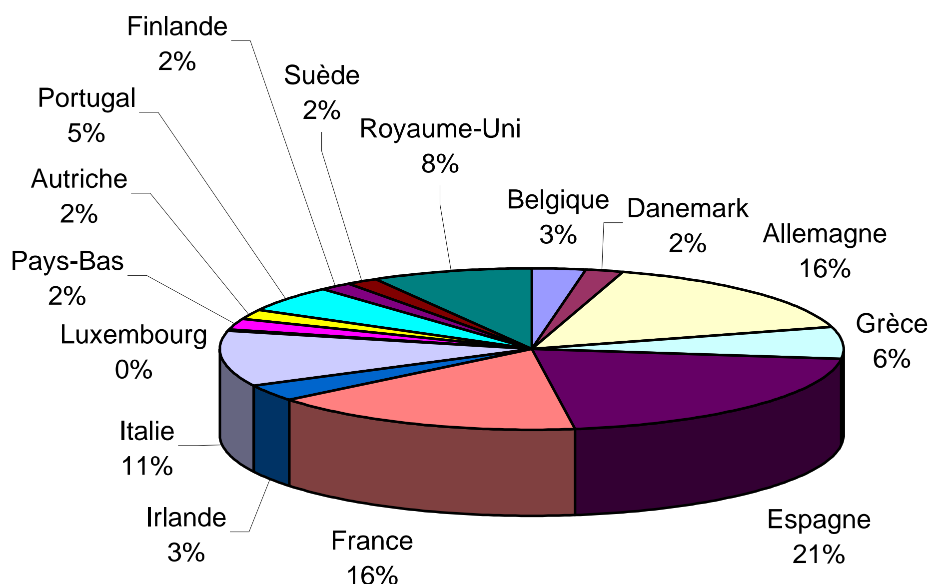
1. The *income* of the European budget is more or less proportional to the GNI of each country, but because of the British correction, the share of certain Member States, including France and Italy, is re-evaluated. In 2002, Germany remains the main contributor to the European budget, contributing 22.6% of the budget's resources (but this figure is on the decline, given that German GNI has been increasing less rapidly than the European average). France is the second contributor, contributing 18.2% (this figure is higher than its share in the EU's GNI [16.7%] because of the British correction). Italy's share amounts to 14.5%, and just as France, it is higher than its share in the EU's GNI. The United Kingdom, on the other hand, finances only 13.1% of the European budget although it represents 18.5% of the GNI of Europe at fifteen. The fifth largest contributor is Spain, with 8.4% of the European budget's resources.

Graph 5. Share of Each Country in the EU's Resources for 2002 in %



2. *Operational expenditure* of the European budget (*i.e.* expenditure incurred because of the common agricultural policy, regional policy and other internal policies) benefit, in order, Spain (21%), France and Germany (16% each), Italy (11%) and the United Kingdom (8%). External expenditure and administrative expenditure are excluded from "operational expenditure" although these expenses could be subject to distribution between Member States according to the location of different institutions (Belgium, Luxemburg and to a lesser extent France would be the main beneficiaries).

Graph 6. Share of Each country in Operational Expenditure for 2002 in %

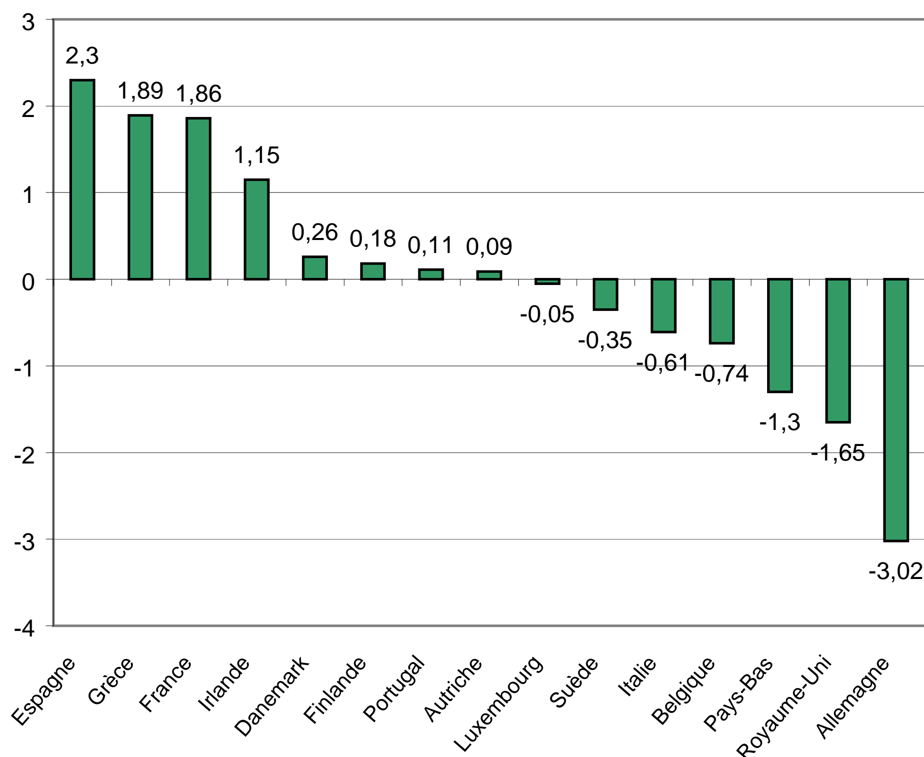


Expenditure on common agricultural policy mainly benefits France (22.5%), Germany (15.7%), Spain (13.7%) and Italy (13.1%). If one compares these amounts to the respective share of different Member States in the budget's income, it becomes clear that Germany and the Netherlands largely "pay" for the benefits that Spain, Greece and France draw from the common agricultural policy.

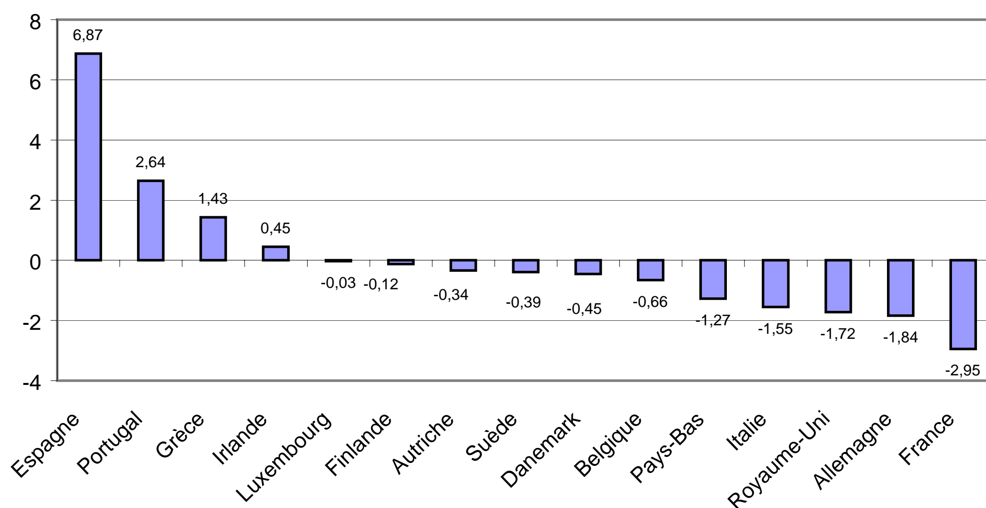
Insofar as *regional policy* is concerned ("structural action"), its main beneficiary in 2002 was Spain (38%), followed by Germany (nearly 15%), Portugal (13%), Greece and Italy (nearly 8%). The United Kingdom and France receive slightly more than 5% of the credits for regional policy. If one were to compare this expenditure to the share of different Member States in the budget's income, Spain would appear to be the principal beneficiary, followed further behind by Portugal and Greece while France, Germany, the United Kingdom, the Netherlands and even Italy would be the main States financing this aid[4].

[4] The case of Italy is special since it benefits from around 15% of the expenditure set aside for regional policy for the period 2000-2006 – in other words, almost as much as Germany – but it faces recurrent difficulties in spending the funds allocated especially to Mezzogiorno. This explains the weak rate of return calculated on the basis of effective payouts (8% in 2002, 12% in 2001).

Graph 7. Beneficiaries and Net Contributors of the Common Agricultural Policy in 2002
(in billions of Euros)

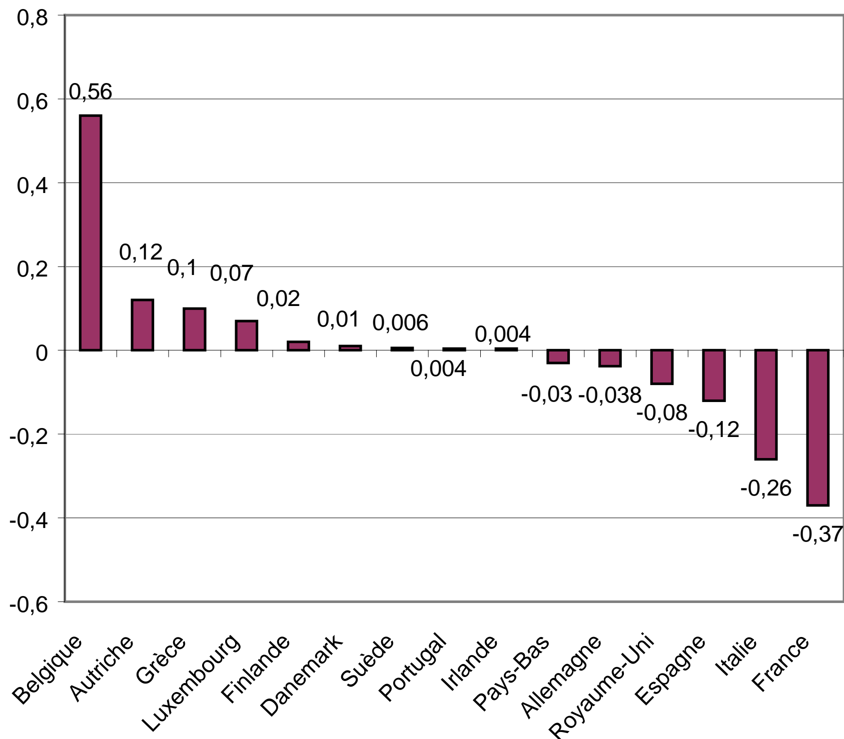


Graph 8. Beneficiaries and Net Contributors of Structural Action in 2002
(in billions of Euros)



Internal policies, meanwhile, are better distributed. Germany enjoys 22% of the credits, Belgium 13%, France and the United Kingdom 12%, Italy 10% and Spain 6%. If we compare its contribution to the budget's income, Spain emerges as the main beneficiary while France and Italy emerge as the main financing States.

Graph 9. Beneficiaries and Net Contributors of Internal Policies in 2002
(in billions of Euros)

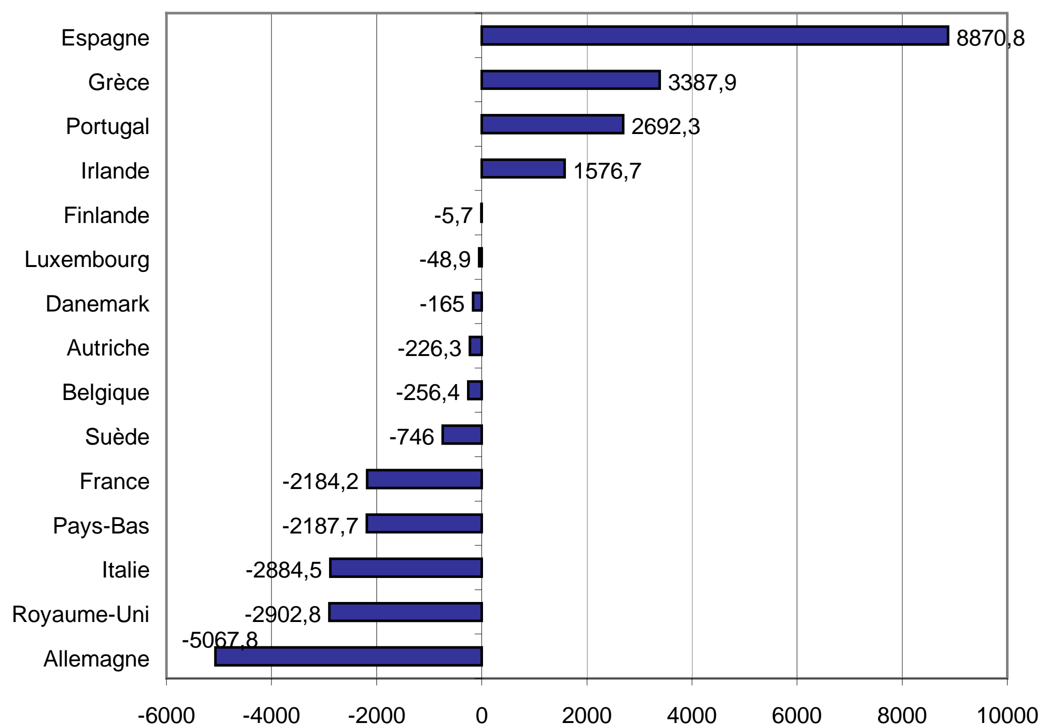


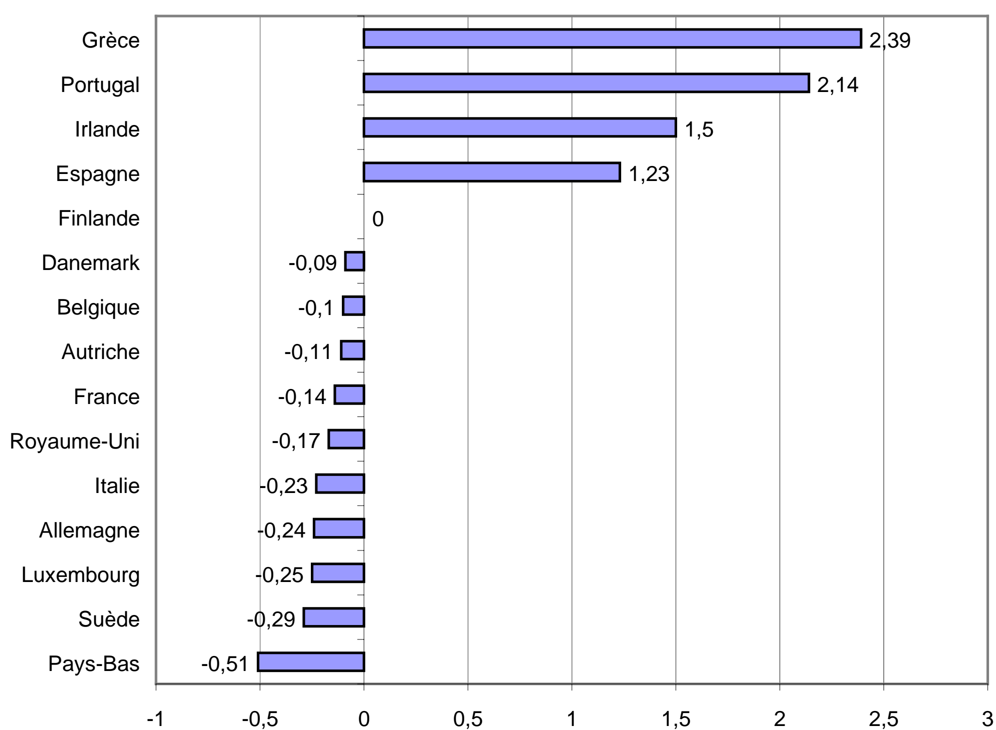
3. The *operational net balances* thereby calculated by the European Commission do not take administrative and external expenditure into account. Hence, such expenditure does not represent real net budgetary balances for the Member States that should be calculated by determining the difference between their gross contributions to the European budget and the corresponding returns on the grounds of common policies (common agricultural policy, internal policy and even administrative expenditure). "Operational" net balances rather reflect the redistributive character of "operational" policies between Member States. The sum of operational net balances is equal to zero, excepted exchange rate differences linked to the payment of the British cheque.

According to the calculations of the European Commission, Germany remains the major "operational" net contributor to the European budget, followed by the United Kingdom, Italy, the Netherlands and France. The main net beneficiaries of the European budget are the "cohesion" countries: Spain, and further behind Greece, Portugal and Ireland.

Germany is a net contributor since it does not benefit from the returns of either the common agricultural policy or the regional policy in proportion to its weight in the EU's GNI (even

Graphs 10 and 11. Operational Budgetary Net Balances in 2002
(in millions of Euros and as a % of GNI)





though its reunification rendered it a major beneficiary of regional policy due to the Länder in the East). However, Germany benefits from a reduction of its contribution to the financing of the British cheque since 2002. In the same year, it also benefited from higher returns through European policies (aid for the floods caused by Elbe). As such, Germany's net contribution is less significant in 2002 (5 billion Euros) than it was in 2001 (7 billion) and in 2000 (8.2 billion).

France, in spite of the benefit it gains through the common agricultural policy, is increasingly becoming a net contributor because of its growing share in the financing of the British cheque. Its net contribution to the European budget was at its highest in 2001 and 2002 (slightly more than 2 billion Euros)[5].

The *United Kingdom* is structurally a net contributor (3 billion Euros in 2000 and 2002), in spite of its "discount". This "discount" aims at correcting the difference between the country's contribution in proper resources and its smaller rate of return on common policies.

Italy is often a net contributor (almost 3 billion in 2002). It benefits little from the common agricultural policy, has difficulties in using up the sums allocated to it through structural funds and must now undergo an increase in its share in financing the British contribution.

The *Netherlands*, benefiting from very little return on the common agricultural policy and practically no return on regional policy, must on the other hand make a high contribution because of its share in Europe's GNI (5%) and also because of the payment of custom's rights when receiving merchandise into Dutch ports. The Netherlands' net contribution was higher than 2 billion Euros in 2001 and 2002.

Spain is the main net beneficiary since it benefits from high returns both from the common agricultural policy and regional policy. Spain's net benefit amounted to almost 9 billion Euros in 2002, against slightly lesser than 8 billion in 2001 and slightly more than 5 billion in 2000.

The same applies for *Greece* (3.4 billion Euros in net benefits in 2002) and *Portugal* (2.7 billion Euros), as well as for *Ireland*, although it now largely exceeds the average European per capita income (1.5 billion Euros in net benefits in 2002).

[5] These figures could be compared to those forwarded by the Department of public accounts: the differential between payments to the European budget and European returns amounted to 3.6 billion Euros in 2001, 3.1 billion in 2002, 3.4 billion in 2003. The European Commission's method for calculating net balances actually minimizes the total net contributions of States.

If we were to measure these operational net balances in relation to the States' GNI, the major relative net contributors would be respectively the Netherlands (0.5% of its GNI), followed much further behind by Sweden, Luxemburg, Germany and Italy (approximately 0.25% of their GNI). The net balance of Greece represents 2.4% of its GNI, while that of Portugal is 2.1%. They are followed by Ireland (1.5%) and Spain (1.3%). The aid offered to the poorest countries of the EU represents, for the latter group of countries, a benefit greater than the relative effort that it costs the richer countries: the net beneficiaries, in the European Union of fifteen, are in actual fact smaller and fewer than the net contributors.

These figures highlight several facts. Firstly, common agricultural policy remains a policy that has its "losers" and its "winners". This partly explains the protests it has been subject to by net contributors. Secondly, cohesion countries are very large beneficiaries of the European budget as it functions today, and they hence have much to lose if doubts are raised at the forthcoming budgetary negotiation about their acquired advantages. Thirdly, the British correction has, with time, turned out to be both a complication in Europe's budget, but also an essential factor of re-equilibrium between contributors.

3. The Challenge of Enlargement

Even without enlargement, budgetary negotiation within a Europe of fifteen would still have been complicated. With enlargement, these negotiations are now even more complicated. The arrival of ten new Member States leads to a 20% increase in the EU's population but with only a 5% increase in its GNI. The new Member States are far less rich. Their accession has a very important impact on the functioning of common policies. This obliges the EU to reanalyze not merely the great financial equilibrium but also the very definition of these policies.

3.1. The Consequences of Enlargement

The new member countries are situated at around 53% of the average per capita GDP in purchasing power parity in a Europe of 25, and at 28% in nominal terms. They are hence not going to contribute greatly to the European budget. On the other hand, they would absorb a large part of the credits of both agricultural and regional policies.

1. Insofar as *income* is concerned, the new Member States only represent 5% of the GNI of the Europe of fifteen. According to simulations, on the basis of the new proper resources decision, they would represent 3.3% of the resources of the EU's budget in 2004

(contributions being due only for the period following their accession on May 1st) and nearly 5% in 2005 and 2006 (full years).

It is nevertheless important to recall that these countries, engaged in a process of catching up with the West, have a higher growth rate. The Europe of fifteen marked an average 2% annual growth rate during the 1990s. It is not unreasonable to believe that the new Member States could have a growth rate that is twice as higher (4% annually). This would increase the contributions that they shall make to the European budget.

2. Insofar as *expenditure* is concerned, the accession of these ten countries considerably shakes up the European budget.

The credits of the *common agricultural policy* could have theoretically been doubled, since the twelve new Member States (including Romania and Bulgaria) together have more farmers than the fifteen old members put together (although they barely represent 22% of the population in an Europe of 27). In Poland and Lithuania, agriculture employs nearly 20% of the active population; in Bulgaria more than 25%; in Romania more than 40%. Given that agriculture in the Eastern countries is by far an agriculture of subsistence, and that aid is a function of productivity, this would limit the amount of aid offered to these countries. But there is a real risk that the peasants of the East (whose income is largely inferior to that of their counterparts in the West) would modernize their agriculture and thereby explode the budget of the common agricultural policy. It may even be possible that the agricultural sector benefits from a crowding-out effect in these countries if the common agricultural policy guaranties, within the agricultural sector, a higher income than in the other sectors of the economy.

Insofar as *regional policy* is concerned, the consequences are however different. If the current criteria are maintained (criteria that focus the major part of European funds towards regions whose per capita GDP is inferior to 75% of the European average), the Eastern countries would be reallocated a large part of these funds that are currently benefiting the “cohesion” countries. According to the calculations of the European Commission, the number of citizens living in regions whose per capita GDP is inferior to 75% of the European average shall increase from the current 68 million (18% of the total population) to 116 million (25% of the total population in an enlarged Europe), 60% whom will be citizens of new Member States. Nearly the entire new population of the European Union will live in regions that qualify for objective 1 (with the exception of Prague, Budapest, Bratislava and Cyprus). Citizens of new Member States would be behind a European Union where 27.80% of its inhabitants live in areas that qualify for objective 1.

This situation presents a great challenge of solidarity and equity for the European Union. Initially, the contributing countries wished to overcome the consequences of enlargement on the common agricultural policy in order to avoid an explosion of expenditure. Regional policy, meanwhile, mainly poses the problem of the reallocation of credits.

3.2. The Decisions Taken in Brussels and Copenhagen

3.2.1. The Brussels agreement

Jacques Chirac and Gerhard Schroeder signed an agreement on the future of the common agricultural policy on the eve of the European Council of Brussels, in October 2002. This agreement was later backed by their partners. It foresees the introduction of a ceiling on intervention expenditure for the common agricultural policy's budget beginning 2007 (with a margin of a 1% increase per year in value, inferior, in all likelihood, to the annual rate of inflation). This ceiling concerns market expenditure that represents 90% of the common agricultural policy's budget (FEOGA-guarantee). Rural development expenditure from either the FEOGA-guarantee (second pillar of the common agricultural policy) or the FEOGA-orientation (structural action) is excluded.

The direct aid made to Eastern countries shall be released gradually, moving from 25% of the Western level in 2004 (impact on the 2005 budget) to 30% in 2005, 35% in 2006, 40% in 2007, and a further 10% per year until achieving 100% in 2013. This gradual release of direct aid to the farmers of the East will ensure a smoothening of agricultural expenditure in the new Member States. But this would also translate into a gradual reduction of the aid handed out to older Member States, and in turn poses the problem of eventual national compensatory measures.

3.2.2. The Copenhagen agreement

The European Council of Copenhagen, in December 2002, then put forward the ceilings on expenditure aimed at new Member States over the period 2004-2006. These ceilings are held in the envelope that was reserved in 1999 for their accession.

The agenda for 2000-2006 foresaw a total of 42.6 billion Euros (at 1999 prices) of commitment credits reserved for the new Member States for the period 2004-2006. The Copenhagen agreement globally confirmed this envelope (41 billion Euros). The new Member States will receive 28 billion Euros over the same period (at 1999 prices) in payment credits. If one deducts these Member States' contribution to the European budget (3.3% in 2004, 5% in 2005 and 2006), *i.e.* 13

billion Euros at 1999 prices, the net cost of enlargement for older Member States lies at 15 billion Euros over the period 2004-2006, *i.e. 15 Euros per person per year* (still in 1999 prices).

In sum, new Member States will be net beneficiaries of the European budget. Their rate of return on expenditure (in commitment credits at 1999 prices) will increase from 11% in 2004 (against 3.3% of resources) to 13% in 2005 and nearly 15% in 2006 (against 5% of resources).

Table 1. The Share of New Member States in the European Budget, 2004-2006
(at 1999 prices, in commitment credits)

	2004			2005			2006		
	Total	New members	%	Total	New members	%	Total	New members	%
Agriculture	44,657	1,897	4.25	45,677	3,747	8.2	45,807	4,147	9.05
Structural action	35,665	6,070	17.02	36,502	6,907	18.92	37,940	8,770	23.12
Internal policies	7,877	1,457	18.5	8,098	1,428	17.63	8,212	11,372	16.71
Administrative expenditure	5,403	503	9.31	5,558	558	10.04	5,712	612	10.71
Budgetary compensations	9,383	1,273	13.57	9,293	1,173	12.62	9,070	940	10.36
Total	*102,985*	*11,200*	*10.88*	*105,128*	*13,813*	*13.14*	*106,741*	*115,841*	*14.84*

The rate of return for new Member States insofar as agricultural policy is concerned will increase to 9% in 2006 (in commitment credits).

The rate of return on regional policy will meanwhile increase to 23% in 2006.

The rate of return on internal policies is less significant (around 17% over the period 2004-2006) but nevertheless much greater than the relative contribution of these countries to the resources of the European budget. A large part of this expenditure deals with transitory support measures (support for nuclear safety, for institutional strengthening and for adapting the Schengen system).

Finally, new Member States obtained, at Copenhagen, certain “budgetary compensations” that increase their global rate of return over the European budget.

It is nevertheless important to note that the new Member States will have to contribute to the financing of the British discount until 2006. This will reduce their “net balance”, although it will remain largely positive. In average, over the period 2004-2006, the positive net balance will represent around 1% of the GNI of the ten new Member States (calculated in payment credits).

The impact on net balances of contributing countries will be in total limited, given that a part of the credits made to the new Member States originate from the pre-accession envelopes that had been reserved for them until now.

3.3. The Stakes for After 2007

Three main questions could be posed for the forthcoming multi-annual agenda.

3.3.1. Which ceiling on expenditure?

Following the European Council of Brussels in December 2003, six of the main contributing countries of the European Union (Germany, France, the United Kingdom, the Netherlands, Austria and Sweden) informed the Commission that they did not wish to see the ceiling on expenditure for the next budgetary agenda exceeds 1% of the EU's GNI.

Inversely, the Commission wishes to benefit from increased resources to finance the enlargement and new common policies. In its February 2004 communication, the Commission fixed a ceiling on payment credits at 1.14% of the EU's GNI (and at 1.26% of commitment credits).

3.3.2. Which reform of common policies?

The more the EU disposes of budgetary resources, the more it would be able to develop its common policies. The more budgetary constraints it faces, the more it will have to choose between a multiplicity of desirable policies.

Through the 2002 agreement, the common agricultural policy saw its resources guaranteed, but with a ceiling, over the period 2007-2013 (in market expenditure). Reform of the common agricultural policy should follow, in harmony with the commitments that the European Union will have to make in the new rounds multilateral commercial negotiation.

The reform of regional policy remains open. It is important to define the effort required from the new Member States that would enable them to catch up with the others in the same conditions as the Mediterranean countries and Ireland since the late 1980s. The share of resources that will be allocated to the older Member States should also be defined, either in terms of areas still eligible for objective 1 or areas that benefit from transitional support after emerging from the plan of action, or in terms of regional policy.

The importance of “new policies” is also to be defined: policies aimed at stimulating growth in the framework of the “Lisbon strategy” (research, education, trans-European networks, etc.); policies for police and judicial cooperation, protection of frontiers and the fight against terrorism; external EU action and defense.

3.3.3. Which correction of net balances?

If the net balances are too disparate and too large, the main “net contributing” States will demand the implementation of corrective mechanisms, in the name of greater equity, in the financing of the European budget. One would either have to maintain the “British cheque” or define a new corrective mechanism.

An eventual European tax, if it could bring forth greater political legibility in the European Union, could only be implemented if the question of net balances is made relative and no longer requires a corrective mechanism. It would also undoubtedly have to be followed by an equivalent reduction in national fiscal pressure on European citizens, failing which a European tax would run the risk of draining the legitimacy of European construction.

4. The Future of the European Budget as Seen Through the Eyes of the Commission

By presenting its communication on the next financial perspectives in February 2004, the European Commission did not wish to limit itself to 1% of Europe’s GNI, as fixed by the six major contributors of the European Union. The Commission has foreseen a considerable increase in the credits allocated for research, education and growth, by (partially) following in the lines of the Sapir report of summer 2003, as well as an increase in the credits aimed at strengthening the international role of the European Union. It has chosen a broad regional policy that is not limited to assisting the poorest countries. Moreover, the budgetary envelope proposed by the Commission respects the ceiling in real terms of expenditure set aside for the common agricultural policy (in conformity to the Brussels agreement of 2002). Finally, the Commission “budgetizes” the European Fund for Development (EFD), which represents around 2 billion Euros per year and which is currently subject to a separate financing than the rest of the European budget.

The difference between payment credits (1.14% of GNI) and commitment credits (1.26%) sidesteps the Commission’s communication: it is the payment credits that determine the amount of each contribution and “net balances” of States, but engaged credits would sooner

or later be transformed into later payments. The Commission respects the ceiling on proper resources (1.24% of GNI excluding the EFD) over the period 2007-2013, but this would no doubt be exceeded in the years that follow.

4.1. Income

The Commission has not taken a stance at this stage on the European tax, but it hopes that this tax could be introduced under three possible forms: tax on the income of firms, an authentic VAT resource, or an energy tax. In the eyes of the Commission, the implementation of a European tax should not add weight to the global fiscal burden of the European citizen, but should still represent a more appropriate mode of financing insofar as a Union of States and citizens is concerned.

Table 2. Global Overview of the New Financial Framework 2007-2013
(Communication of the Commission, February 2004)

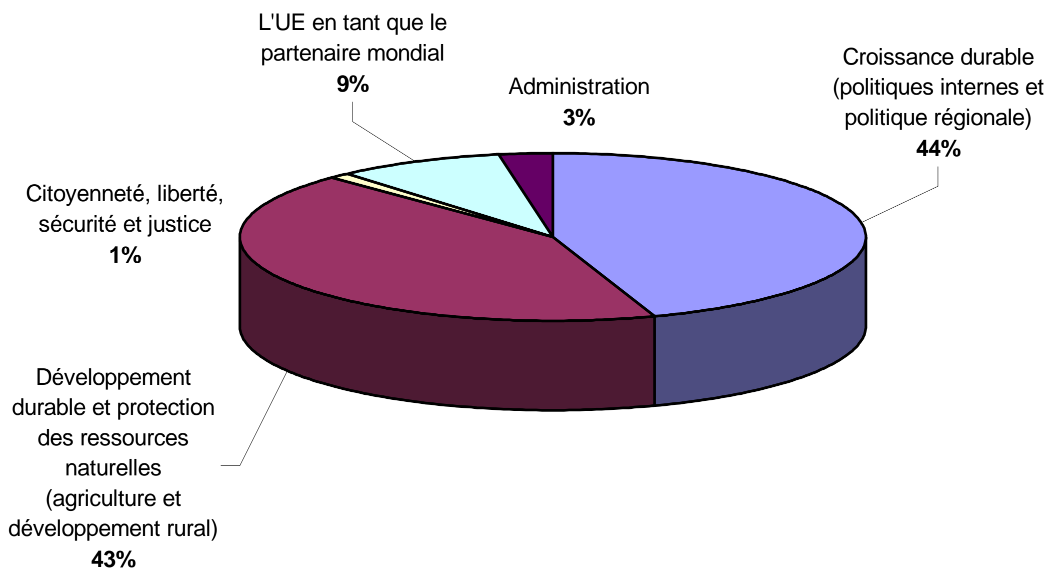
Commitment credits	2006 (a)	2007	2008	2009	2010	2011	2012	2013	
1. Durable growth	47.582	59.675	62.795	65.800	68.235	70.660	73.715	76.785	
1a. Competitiveness for growth and employment (b)	8.791	12.105	14.390	16.680	18.965	21.250	23.540	25.825	
1b. Cohesion for growth and employment	38.791	47.570	48.405	49.120	49.270	49.410	50.750	50.960	
2. Sustainable development and protection of natural resources	56.015	57.180	57.900	58.115	57.980	57.850	57.825	57.805	
of which: Agriculture market expenditure and direct aid expenditure	43.735	43.500	43.673	43.354	43.034	42.714	42.506	42.293	
3. Citizenship, freedom, security and justice	1.381	1.630	2.015	2.330	2.645	2.970	3.295	3.620	
4. The EU as a global partner (c)	11.232	11.400	12.175	12.945	13.720	14.495	15.115	15.740	
5. Administration (d)	3.436	3.675	3.815	3.950	4.090	4.225	4.365	4.500	
Compensations	1.041								
Total commitment credits	*120.688*	*133.560*	*138.700*	*143.140*	*146.670*	*150.200*	*154.315*	*158.450*	
Total payment credits (b) (c)	*114.704*	*124.600*	*136.500*	*127.700*	*126.000*	*132.400*	*138.400*	*143.100*	Average
Payment credits as a percentage of GNI	1.09%	1.15%	1.23%	1.12%	1.08%	1.11%	1.14%	1.15%	1.14%
Available margin	0.15%	0.09%	0.01%	0.12%	0.16%	0.13%	0.10%	0.09%	0.10%
Ceiling of proper resources as a percentage of GNI	1.24%	1.24%	1.24%	1.24%	1.24%	1.24%	1.24%	1.24%	1.24%

In millions of Euros at 2004 prices
(a) The 2006 expenditure with the framework of current financial perspectives was designed according to the new nomenclature proposed for reasons of reference and for facilitating comparison.
(b) Including expenditure for the Solidarity Fund (1 billion Euros in 2004 at current prices) beginning 2006. The corresponding payments are uniquely calculated from 2007 onwards.
(c) The integration of the European Fund for Development into the EU's budget should be effective in 2008. Commitments for 2006 and 2007 are included for purposes of comparison. Payments for commitments before 2008 are not taken into account in the payments.
(d) Including the administrative expenditure of institutions other than the Commission, pensions and European schools. The administrative expenditure of the Commission is integrated into the first four chapters of expenditure.

4.2. Expenditure

The Commission has placed the future expenditure of the European budget under five categories. Beyond the optical effect that puts agriculture in the second budgetary post while giving first place to “sustainable development” expenditure (cohesion and competitiveness), the Commission does indeed operate significant re-orientations.

Graph 12. Structure of Commitment Credits in 2007



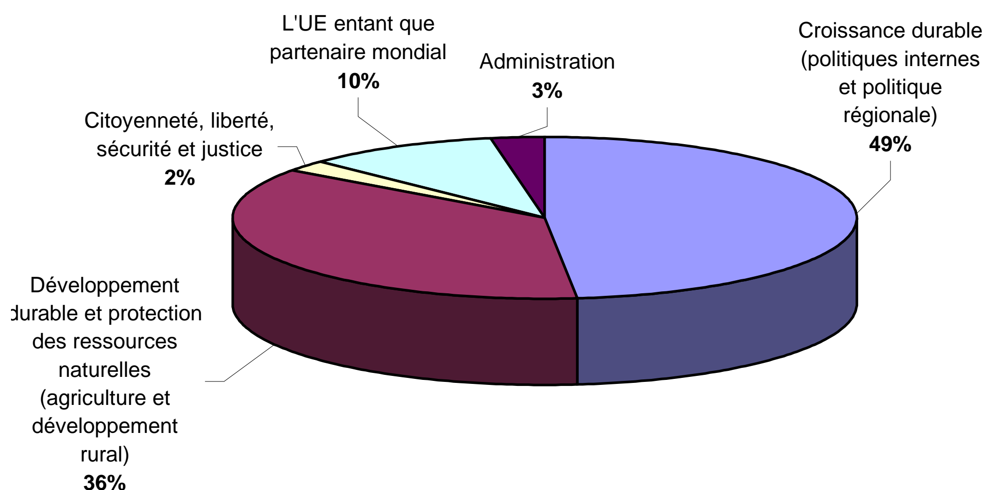
1. The credits allocated to *sustainable development* include a major part of old internal policies as well as regional and cohesion policies. This section shall occupy, from 2007 onwards, the first place in expenditure categories of the European budget, and shall represent, in 2013, half of the budget’s expenditure.

Still more important, the Commission plans to triple the real value of competitive expenditure (research, trans-European networks, education and employment, etc.) in comparison to 2006.

The credits for regional policy will also be significantly increased. They represent 0.42% of European GNI for the period (in commitment credits), but one should also add structural action in favor of poor rural regions (transferred to the agricultural expenditure category). This considerably large envelope (370 billion Euros at constant perimeter over the period 2007-2013) aims at maintaining an ambitious regional policy for the entire European Union

and not merely for the new Member States. These new members would only receive 52% of the total credits.

Graph 13. Structure of Commitment Credits in 2013



2. The category "*sustainable development and natural resources*" includes both traditional agricultural expenditure of the FEOGA-guarantee (market expenditure and rural development expenditure) as well as FEOGA-orientation expenditure that today lie in the category of structural policy. Not only is the market expenditure subject to a ceiling in real terms and conforming to the Chirac-Schroeder agreement ratified by the fifteen Member States, but also, the entire agricultural budget is stabilized in constant Euros. It thus considerably decreases in relative terms: expenditure set aside for agriculture and rural development will represent slightly more than a third of the total EU budget in 2013, as opposed to half in 2006.

The change in name moreover reflects the continuous restructuring of a policy that offers an ever-decreasing amount of support to agricultural productivity and pays increasing attention to environmental preservation and rural development.

3. The "*citizenship, freedom, security and justice*" category is also being allocated increasing sums of money: these expenses almost triple in absolute value between 2006 and 2013, even though they barely represent more than 2% of total expenditure at the end of the period. This development is the result of the creation of a common area for police and judiciary cooperation which began in Maastricht (this was then referred to as the "third pillar",

of an intergovernmental nature) and later saw a marked acceleration since the Treaty of Amsterdam. Policies as varied as surveillance of the Union's external frontiers, asylum and immigration policies, the fight against crime and terrorism, police and judicial cooperation are included in this category.

4. Expenditure in the "*European Union as a global partner*" category has also been rising significantly. This expenditure would represent 10% of the European budget in 2013, and would then include expenses from the European Fund for Development. Pre-accession aid (to Turkey, Romania, Bulgaria and the Balkan States) would also be included in this category. Other expenses in this category also include development aid and aid to the EU's peripheral countries.

5. *Administrative expenditure* remains limited (3% of the EU's budget), but the Commission's presentation is sidestepped by the fact that the Commission's administrative expenditure is included in the other categories of expenditure. The Commission being by far the most important European institution, this post is hence largely under-estimated.

4.3. Estimation of Net Balances

The Commission, in its communication, did not gamble on calculating the net balances of Member States, and it limited itself to suggesting the replacement of the "British discount" by a "generalized corrective mechanism". Simulations are required for understanding the question of net balances in detail.

4.3.1. Net balances without a corrective mechanism

It is important to distribute the income and the expenditure of different Member States in order to calculate net balances. The simulations that were made have been obtained through a certain number of hypotheses. For further information, readers could refer to the statistical annex that offers information that has been used to this aim.

The calculations are based on payment credits and not on commitment credits since it is the payments carried out in a specific year that determine a State's contribution, payments for common policy as well as net balances. As such, it is the sum of 143 billion Euros that has been selected. The ceilings on different categories of expenditure have been proportionately recalculated according to this basis.

Table 3. Distribution of operational income and expenditure in 2013
(Communication of the Commission, payment credits, 2004 prices)

	Resources		Competitiveness expenditure		Cohesion expenditure		Direct agricultural expenditure		Rural development expenditure	
	%	Million €	%	Million €	%	Million €	%	Million €	%	Million €
Germany	21.30	30,476	13.86	3,232	9.40%	4,326	11.28%	4,308	8.56%	1,200
UK	17.21	24,620	13.86	3,232	2.90%	1,335	7.68%	2,933	4.09%	572
Italy	12.93	18,499	10.23	2,386	6.20	2,853	10.32	3,942	7.31	1,024
Netherlands	4.56	6,521	5.95	1,388	0.70	322	2.16	825	1.08	151
France	15.53	22,225	12.74	2,972	4.40	2,025	17.76	6,784	9.28	1,300
Sweden	2.51	3,593	2.98	694	0.60	276	1.52	581	0.78	109
Ireland	1.12	1,597	1.58	369	0.60	276	3.04	1,161	1.87	262
Portugal	1.30	1,863	1.67	390	3.10	1,427	1.68	642	2.66	373
Greece	1.40	1,996	3.26	759	5.40	2,485	5.04	1,925	5.83	816
Spain	6.98	9,981	5.67	1,323	13.20	6,075	11.92	4,553	12.12	1,698
Austria	2.14	3,061	2.51	586	0.70	322	2.00	764	1.04	145
Other old members (4)	6.05	8,650	18.69	4,360	0.80	368	5.60	2,139	2.89	405
New members (12)	7.00	10,017	7.00	1,633	52.00	23,932	20.00	7,639	42.50	5,954
Total	*100.00*	*143,100*	*100.00*	*23,323*	*100.00*	*46,023*	*100.00*	*38,196*	*100.00*	*14,009*

Insofar as *income* is concerned, a 4% annual growth rate for new Member States has been estimated, as opposed to a 2% growth rate for old Member States. The share of the ten new Member States is estimated at around 5% of the EU's income in 2005 and 2006. Romania and Bulgaria will increase the EU's GNI by less than 1% beginning 2007. In sum, taking account of the growth differential, the contribution of the twelve new Member States in 2013 should barely reach 7% of the EU budget's income. The remaining income (93% of the budget in payment credits) was distributed amongst older Member States on the basis of the GDP/GNI key for 2002 (following the report on distributed operational expenditure) but this would of course suppose that the GNI of all these countries increase in a uniform manner until 2013, and this indeed, is far from being guaranteed.

The distribution of *expenditure* between Member States is divided between the estimated share that is allocated to the new Member States, and the remaining sums that are distributed amongst the old Member States by using the rate of return of the EU Commission's report on distributed operational expenditure.

As for *competitive expenditure*, that corresponds to the former "internal policies", it is the 2001 distribution key that was used for old Member States, since the 2002 figures had overestimated Germany's returns because of exceptional aid offered to it due to floods. The 7% figure (corresponding to their share in the EU's GNI) was chosen for the new Member States. This probably is an underestimation if we are to compare it with their share in internal policies over the period 2004-2006 (refer table 1). The share of Belgium (included in the

category “other old Member States”), traditionally having benefited from returns in internal policies, could on the other hand be overestimated.

Insofar as *cohesion expenditure* is concerned, the figure of 52% of funds allocated to new Member States by 2013 is well-known. Indeed, 78% of the credits for the cohesion policy should be allocated to objective 1 (regions with retarded growth whose per capita GDP is inferior to 75% of the EU’s average) and the new Member States should obtain around 65% of these credits. Most of the new members would not be targeted by the new objective 2 (18% of the total envelope), with the exception of Cyprus, Bratislava, Prague and Budapest who do not qualify for objective 1 (and who represent 8% of the population of the ten adhering countries in 2004). The new members shall slightly benefit from objective 3 (trans-border programs) whose envelope is limited (4% of the total envelope put aside for regional policy).

Old Member States shall benefit from objective 1 for poor regions (ex. French overseas *départements*, a majority of East German Länder and some Spanish regions), from objective 1a (transitional aid for regions not falling into objective 1 because of the “statistical effect”), from objective 2 (fusion of former objectives 2 and 3), and also from objective 3. In order to distribute cohesion policy expenditure between old Member States (48% of total credits), we have made use of the report on distributed operational expenditure for the year 2001 since that of 2002 was more favorable to Spain and Portugal. In order to distribute the expenditure of objective 1 (including objective 1a), we have made use of the distribution key of objective 1 in 2001. Old Member States will receive 35% of the credits of objective 1 which itself represents 78% of the envelope set aside for regional policy. In order to allocate expenditure for the new objective 2 (18% of the credits set aside for regional policy), we calculated the average rate of return for each country for objectives 2 and 3 in 2001 (since the new objective 2 could be substituted for former objectives 2 and 3). Finally, for expenditure regarding objective 3, we based ourselves on the rate of return of “EU initiatives”. The global rate of return for Greece and Portugal were slightly increased since these two countries (unlike Spain and Ireland) will continue to benefit from the credits of the “cohesion fund” with objective 1.

Finally, insofar as *agricultural expenditure* is concerned, we have identified market expenditure and rural development expenditure that henceforth blend the “second pillar” of the common agricultural policy with structural aid to rural regions experiencing retarded growth.

As far as market expenditure is concerned, a global estimation of 20% was made for new Member States. This estimation was calculated with the help of French and European administrative sources. The newly entering countries of 2004 will then be at a 100% level in direct aid. Romania and Bulgaria, if they do indeed enter in 2007, would achieve this level only in 2017. The Commission has foreseen a budget of direct aid that shall include Romania and Bulgaria. Market expenditure in the former Member States (80% of the total envelope) were distributed by using the distribution key of 2001 since that of 2002 overestimated Germany's returns because of the floods.

Insofar as rural expenditure is concerned, we calculated the average rate of return on the FEOGA-guarantee and the rate of return on objective 1 (which conditions the use of FEOGA orientation). The new Member States would thus obtain 42.5% of the credits.

The sum of *non-distributed expenditure* remains limited to 15% of the European budget (figure similar to that in the 2002 report on distributed operational expenditure). Such expenditure includes external expenditure, expenditure linked to the area of freedom, security and justice and administrative expenditure. The Commission's administrative expenditure is integrated into various categories of expenditure within the financial framework presented by the Commission itself. If we were to remove this expenditure, the sum of non-distributed expenditure would be higher and the net balances would be less favorable to the Member States. But we did not distribute the expenditure linked to police and judicial cooperation between Member States. This expenditure is roughly similar to the administrative expenditure of the Commission and we estimate that there exists a certain form of compensation here.

The results of these estimations bring forward the *projected net cost of enlargement in 2013*: more than 29 billion Euros at 2004 prices, which, when put beside the number of inhabitants in the old Member States, represents *more than 75 Euros per person per year* (five times more than for the period 2004-2006). The rate of return for new Member States as regards the European budget would be higher than 27% in 2013 (on the basis of twelve Member States), as opposed to 15% in 2006 (on the basis of ten new Member States). But one must be conscious that this is a point of arrival: the rate of return will increase over the period as agricultural and regional aid will be paid in increasing proportions to the new Member States. Inversely, the old Member States will receive increasingly lower amounts of aid from the common agricultural policy as well as transitional aid from the regional policy ("phasing out" of objective 1a).

In the absence of any correction of net balances, Germany and the United Kingdom will remain the biggest net contributors to the European budget (more than 16 billion Euros each per year). Several countries would be in a net contribution level higher than 0.6% of their GNI: the United Kingdom (0.77%), and also the Netherlands, Germany and Sweden. France, in spite of its return on agricultural expenditure, becomes an important net contributor merely because of enlargement (0.47% of GNI in 2013). On the other hand, the cohesion countries would remain net beneficiaries, especially Greece who would continue to "profit" from the European budget for more than 2% of its GNI (as opposed to 3.35% for new Member States).

It is interesting to compare these net balances to those of 2002, not to the "operational balances" of the European Commission (which exclude administrative and external expenditure), but to the "real" net balances that have been recalculated for the entire expenditure of the European budget. These "real" balances reflect the difference between the States' contributions to the entire European budget and their returns through the common agricultural policy, structural actions and through internal policies. If we were to integrate administrative expenditure, Belgium and Luxemburg would become net beneficiaries since these expenses are carried out within their own territories.

This comparison enables us to measure the real change in the net position of Member States between 2002 and 2013. All Member States have marked degradation in their position, with the exception of Belgium and the Netherlands (beneficiaries of the "new policies" of competitiveness) and Greece (who remains a net beneficiary of the European budget at the same previous level). If it were to lose its cheque, the United Kingdom would be penalized at around 0.5% of its GNI. The degradation of the German position nears 0.3% of GNI, that of Austria and France 0.25%, that of Sweden and Italy 0.2%. Ireland, Portugal and Spain lose a large part of the benefits of the European budget.

4.3.2. Net balances after the British correction

If we were to apply the British correction, the British net contribution would be reduced by more than 11 billion Euros in 2013 (at 2004 prices) and would be brought to 0.26% of its GNI. We distributed this correction to other Member States for the current year (2013), although it is normally attributed for the following year. Taking economic growth into account, this method of calculation slightly falsely distorts the impact of the British correction as a GNI percentage and pushes it upwards.

Table 4. Comparison of net balances in 2002 and 2013
(following the Commission's Communication, figures for 2013 at 2004 prices)

	Real net balances 2002		2013 Balances before correction		2013 Balances after British correction		2013 Balances after generalized cheque		2013 Balances after ceiling	
	Million €	% GNI	Million €	% GNI	Million €	% GNI	Million €	% GNI	Million €	% GNI
Germany	-7,710	-0.37	-17,410	-0.66	-18,119	-0.68	-15,359	-0.58	-13,250	-0.50
UK	-5,134	-0.30	-16,548	-0.77	-5,516	-0.26	-13,236	-0.62	-10,705	-0.50
Italy	-4,233	-0.34	-8,293	-0.52	-10,769	-0.67	-8,565	-0.53	-8,043	-0.50
Netherlands	-3,314	-0.77	-3,834	-0.68	-3,986	-0.70	-3,323	-0.59	-2,835	-0.50
France	-3,725	-0.24	-9,144	-0.47	-12,119	-0.63	-10,017	-0.52	-9,663	-0.50
Sweden	-1,077	-0.42	-1,934	-0.62	-2,017	-0.65	-1,771	-0.57	-1,562	-0.50
Ireland	1,456	1.39	471	0.34	257	0.19	248	0.18	-71	-0.05
Portugal	2,580	2.05	968	0.60	719	0.44	708	0.44	336	0.21
Greece	3,226	2.28	3,990	2.30	3,722	2.14	3,711	2.14	3,312	1.91
Spain	8,023	1.17	3,668	0.42	2,332	0.27	2,274	0.26	281	0.03
Austria	-422	-0.21	-1,244	-0.47	-1,315	-0.49	-1,374	-0.52	-1,331	-0.50
Other old members (4)	-1,909	-0.32	-1,379	-0.18	-2,537	-0.34	-2,587	-0.37	-3,761	-0.50
New members (12)			29,141	3.35	27,800	3.19	27,742	3.18	25,742	2.96
Total	*-12,241*		*-21,549*		*-21,549*		*-21,548*		*-21,549*	

The application of the financing of the British cheque according to the 1999 mechanism, as used today, essentially weighs upon France and Italy who join the main net contributors of the European budget (Germany, the Netherlands and Sweden). French net contribution will increase to 0.63% of its GNI. The old countries from the cohesion shall remain net beneficiaries, but to a lesser extent, and the net benefit of the new Member States would barely be reduced. This scenario does not fundamentally modify the "cost of enlargement" which would remain close to 28 billion Euros in absolute terms.

If we compare these figures to those of 2002, we see that France is the country that is the most penalized by the system of the British cheque (degradation of 0.4% GNI). The French net contribution would more than triple between 2002 and 2013. Inversely, the United Kingdom would in no manner contribute to the solidarity effort implied by enlargement, and paradoxically, it would even see an improvement in its position as percentage of GNI!

4.3.3. The generalized cheque

The Commission plans to replace the "British cheque" by a generalized corrective mechanism: all countries having a negative net balance superior to 0.3% of its GNI shall be reimbursed two thirds of this surplus; the total of the "cheques" that will thus be redistributed amongst all Member States according to their share in the income of the EU budget.

The application of this mechanism would lead to a considerable "erosion" of the negative net balances of the main net contributing countries, which all have net balances that lie within the range of 0.5% and 0.6% of their GNI. The United Kingdom would pay dearly for abandoning its cheque: it becomes the major net contributing country in GNI percentage, but it also is the country that most profits from the corrective mechanism. The net benefit for the new Member States and the old "cohesion" countries is, on the other hand, barely modified. We notice that the Netherlands would be the only net contributing country that would benefit from this system in comparison to 2002. This is explained by its very high net contribution to the EU's current budget.

This scenario is equitable, but the generalization of the British cheque poses a problem of principle and of transparency: it transforms the European Union into a "bank account" where the return and the contributions are put into balance, and it further complicates European public finances. Moreover, it presupposes that the United Kingdom would agree to give up almost 70% of its cheque.

4.3.4. The correction of balances with a ceiling mechanism of 0.5% GNI

Another hypothesis – not presented by the Commission – would be to carry out a pure and simple ceiling of net balances, *i.e.* every contribution exceeding a certain net balance limit would lead to a total refund, so as to bring back the net balance to this reference value. The value 0.5% of GNI was taken as an example.

Three groups of countries could be identified in this scenario.

In the first category, all countries who are naturally net contributors see their contribution limited to 0.5% of GNI. They all benefit from the system, with the exception of Belgium (in the category "other old Member States"). The United Kingdom loses a part of its correction, but shall find itself in a largely more favorable situation than in a scenario without any corrective mechanism or even in the scenario of a generalized cheque. Compared to the situation in 2002, all these countries are losers, excepting the Netherlands, whose position shall improve.

The second category consists of countries who, as Ireland and Spain, cease becoming net beneficiaries of the European budget, or who very slightly remain beneficiaries (Portugal).

Finally, the third category is made up of new Member States and Greece who, in spite of the corrective mechanism, remain significant net beneficiaries of the European budget. In this scenario, the “cost of enlargement” for the old Member States slightly decreases (70 Euros per person per year, instead of 75). It is nevertheless possible that certain new countries, because of their economic development and their high level of relative wealth, could join the second category of countries (ex. Slovenia, Cyprus, Malta).

5. Conclusions

The preceding estimations are only indicative. They are based on a certain number of hypotheses taken as true, that have been scrutinized by the European Commission and French authorities, but these hypotheses cannot be perfectly correct. The results should be interpreted roughly.

These results clearly indicate the consequences of the “poverty shock” that is represented by the EU’s enlargement. Regional policy profoundly reallocates the EU budget’s expenditure in favor of the new Member States. The redistributive effects of the agricultural policy are thus made relative. France and Germany, traditional beneficiaries of the common agricultural policy do not avoid degradation in their position. In spite of this there still remain substantial differences between net contributors. The principle of *financial solidarity* which initially guided the European budget can barely be re-established.

We cannot but insist that “net balances” are only imperfect and partial indicators of States’ interests. The effort of solidarity required in favor of new Member States could indeed turn out to be very beneficial for the entire European Union if the economic catching-up of these countries leads to increased growth in the entire European economy (not to mention the political gain to be made thanks to a more homogenous, more integrated, more stable and economically stronger Europe).

The choices made by the European Commission on the size of the European budget and on the distribution of expenditure need to be analyzed and discussed. The scenario of a generalized cheque or a ceiling of balances is the steepest slope of the Commission’s proposals, insofar as it enables the limitation of the cost of European solidarity and that it rallies the support of the main contributing countries. But it would presuppose the accord of the United Kingdom, who would lose its advantageous position because of the corrective

mechanism. Another solution would be to reduce the size of the British cheque while at the same time preserving the current mechanism of distribution.

In any case, these simulations clearly highlight the increasingly debatable character of the British cheque which, from an initial correction of a specific problem in agriculture, has now led the United Kingdom to be largely exonerated from the effort of European solidarity and not to take up its responsibilities in the budgetary choices whose cost it merely partially bears (especially the cost of enlargement, where the United Kingdom was a strong supporter of enlargement). This situation is even more unjust since the United Kingdom now has a contributive capacity that is situated well within the European average (which was not the case earlier).

Finally, we should pose the question, given the solidarity effort that is required from net contributing countries, how could we take account of it when applying the rules of the "stability pact" which limit public deficit to 3% of the GDP? The real net balances of the major net contributing countries could, in 2013, represent between 20%-25% of the level of deficit authorized to certain countries. There is an apparent contradiction between the budgetary effort required from the contributing countries in the name of solidarity, and the budgetary discipline that is required from them through the stability pact. Here, the question of the European budget draws nearer to a more political question: that of budgetary coordination in the Euro zone.

References

European Commission (2004), Communication on PF 2007-2013, February.

European Commission (2003), Distribution of EU operational expenditure by Member State in 2002, September (<europa.eu.int/comm/budget/agenda2000/reports_en.thm>).

Marc Laffineur and Serge Vinçon (2004), *Rapport au Premier ministre sur « les perspectives financières européennes 2007-2013 »*, Paris, La Documentation française, Bibliothèque des rapports publics (<ladocumentationfrançaise.fr/brp/notices/044000098.shtl>).

Marc Lechantre and David Schajer (2004), *Le Budget de l'Union européenne*, Paris, La Documentation française, réflexe Europe.

Projet de loi de finances pour 2004. Relations financières avec l'Union européenne, Paris, Imprimerie nationale.

André Sapir *et al.* (2004), *"An Agenda for a growing Europe*", Oxford, Oxford University Press, March.

Part Two

Which Future for Common Policies?

Future of the EU Budget and Financing of Common Policies

JACQUES LE CACHEUX[1]

The end of 2003 and the beginning of 2004 didn't leave any doubt about the tensions inside the process of European building at the moment of the EU enlargement by 10 new Member States and the election of a new European Parliament through universal suffrage, especially at the time when negotiations of new financial prospects for 2007-2013 were about to start.

Two Brussels crises illustrated immediately the impasse of the European institutions as well as how impossible it was to agree upon the rules of the game acceptable for all the national governments of the Member States. First, at the end of November a communication from the Commission which had condemned German and French budgetary policies whose efforts to balance the budget in 2004 were considered insufficient, was rejected by a small majority of the Ecofin Council. Second, mid-December the Council of Europe was expected to adopt a constitutional treaty drawn up by the Convention presided by Valéry Giscard d'Estaing and which had already been discussed by the Intergovernmental Conference for months but, unfortunately, the project failed. In fact, Spain and Poland refused obstinately the new rule of the qualified majority which had been proposed for future decisions to be taken by the Council. In order to dramatize the antagonisms even more, the Commission declared on January 14, 2004 that it was going to quote the Council in front of the Court of Justice of the European Communities for nonobservance of the budgetary treaties. The budget rules of the monetary union were flouted by the biggest countries, that is to say by the same ones that had imposed them to the Amsterdam treaty in 1977 despite small and indignant countries and their rather lax requests.

There's also an opposition between small, big and "almost big"[2] countries in the matter of decision rules. According to the size of the Member States, the obstacles are more or less

---

[1] Jacques Le Cacheux is a professor at the University of Pau et des Pays de l'Adour, Director of the Research Department at the Observatoire Français des Conjonctures Economiques (OFCE).

[2] After the last enlargement, the EU is composed of 25 Member States. Four of them are "big" (Germany with a population of 80 million people, France and the United Kingdom with a population of at about 60 million people each), two are considered as "almost big" (Spain and Poland with a population of at about 40 million people each) and then, there are 19 "small" countries (more or less, with on one side the Netherlands with almost 16 million people and, on the other side, Malta, whose

serious and their splits more or less deep. The European Union of 25, and soon of 27 or even more is already experiencing the difficulties of common life in a numerous and heterogeneous union whereas a more limited and a better integrated Euro zone can't manage to develop the right macroeconomic politics.

In such a context, it's not a surprise if the budget size and its composition do not reach a consensus. That's why the governments of the six net contributors to the present EU budget, expressed again, in a letter sent to the President of the Commission how essential it is to contain the expenditure. They even suggested to limit the total at 1% of GNI which would correspond to the amount actually spent and not at 1.24% – today's limit in theory. In July, the Sapir report which respected these global constraints suggested a rather radical use of the EU expenditure where big and current common policies such as Common Agricultural Policy (CAP) or structural and regional policies would be sacrificed or nationalized again. Also, in this case, financial means would be concentrated on research and development in order to maximize the potential of the European growth in accordance with the Lisbon objectives. No matter how questionable this proposal is[3], it still represents an interesting beginning for any future analysis.

The objective of this article is to make us consider which common policies we should choose as well as to think of their budgetary implications in the EU. We'd also like to see what is desirable or feasible, what could be a norm or just positive. In the first part we'll begin with an analytical interpretation based on distinction, traditional among economists starting from Richard Musgrave and used later again by Wallace Oates, between three big categories of functions practiced by the public power and their different levels in a decentralized structure, so that later we can precise economic justifications of a common policy and, at the same time, how short the operational reach of these categories is. The second part deals with an examination of possibilities and needs as regards the allocation of resources as well as the concept of European "collective" or "public goods". The analysis proposed by the MacDougall report more than 25 years ago will be used, updated and examined critically again in the second part. In the third part we'll present few results of today's common policies – such as CAP or structural and local policies – and discuss different proposals how to reform them or, even, how to give them up. The fourth part gives a draft of two different concepts of common policies and European budget and leads to two strategies how to reach common objectives.

---

population is not bigger than 350 000 people). For these questions see Laurent and Le Cacheux (2004).

[3] See the critical analysis of this report in Le Cacheux and Sterdyniak (2003).

And, finally, the fifth part shows us how we can learn some lessons from this analysis before we start working on the budget plan for the next few years[4].

1. Functions of a Member State, Economic Interdependence and Spillover

European building and budgetary negotiations are so difficult, especially when it concerns the future of common policies, generally based on the will of both parties to preserve or to amend "achievements of the community" but also on the will to guarantee at the same time "a fair return", that they start to hide real reasons for which common policies are imagined or developed. Economic analysis of public finances, especially Arthur Pigou's one in the 1940s and Paul Samuelson and Richard Musgrave's ones in the 1950s, developed a whole range of economic justifications for interventions launched by public power. As it's well-adapted to an institutional context, decentralized from federalism, such an analysis can be considered as a useful guide how to consider the repartition of competencies between different levels of government. Its implications are very close to those coming from a "classic" political analysis of integration based on the concept of "spillover".

According to the economic analysis, external effects and public goods are the main justification for any public intervention in the spontaneous functioning of a free market. In such circumstances strategic interdependence caused by mutual influence of individual choices can not make this decentralized and non co-operative balance optimal. If, in one way or another, external effects are made internal, public intervention may re-establish an optimal situation provided that, of course, it's correctly carried out and that its objectives correspond to the objectives of the citizens.

On the other side, the classic political theory of integration, which is also called functional theory, builds dynamics of common policies as well as the decentralization of competencies on the similar concept of spillover. The concept of spillover is also considered as a result of

[4] Let's say straightaway that on the subject of the long-term and temporal character of the choices which were made, even if Jacques Delor's proposal of a European budget for several years in 1988 was interpreted as big progress for the European budget, it still represents a problem of legitimacy. It especially concerns the guidelines proposed in 2004 by an outgoing Commission and which are to be discussed in 2005 by the Council and the European Parliament elected in June 2004 for five years. All the decisions made at the end of 2004 and in 2005 during the Dutch and Luxemburg presidency will cover the period between 2007 and 2013 that goes much over the term of the Parliament and Commission's office as well as over the mandate of the national governments sitting in the Council. In this way, all the decisions already made have a strong influence on the future decision which makes this process pretty inert. So, though we live in a real democratic country, how can we judge in advance how tomorrow's members of the European Parliament will chose to incur expenses?

interdependence, reinforced by dynamics of market integrations. Theoretically speaking, this approach confirms the conclusions of the previous one as far as the choice of the domain of the common intervention is concerned.

A suitable analytical distinction, introduced by Musgrave, between three essential types of State's functions – allocation of resources (for the equipment of public goods), distribution of income and wealth (redistribution) and stabilization of the present economic trends –, represents a useful method to analyze Europe's common policies. According to the theory of financial federalism (Oates 1972, 1999), distribution of competencies between different levels of government in a decentralized structure should be led in the way to avoid, as often as possible, any excess between different local entities. And, of course, that's the reason why in a federation with single currency, well-integrated market and strong mobility of population we cannot but strongly advocate centralization of distribution and stabilization as well as the pooling of common goods with significant interdependence. That is to say, only those which are not too much locally-oriented.

2. Which "European Public Goods" do we Mean?

Though intellectually it may look attractive, such an analysis is not directly operational. That is to say, it allows too much latitude when analyzing how strong interdependence between competencies is or the way the centralization may be required. When it's applied to traditional public goods, such as kingly functions of the States, it helps to justify the common establishment of "public goods", such as common defense, common foreign policy, common customs services, common frontiers' police, etc, but only as part of previously defined political choices. And, unlike usual conclusions of the classical theory of budgetary federalism, neither the functions of allocation nor those of a temporary economic stabilization clearly depend on Europe. The reasons for that are population's weak mobility and poor integration of the capital goods market.

In one of the first attempts to apply this approach to the distribution of competencies in a "pre-federal" Europe, the authors of the MacDougall report (European Commission 1977) considered several scenarios how to make the integration of public finances accompany and consolidate the integration of markets and monetary unification – which was, at that time, something very far and imprecise. The least ambitious scenario consisted in allocating defense to the European level which would have led to a European budget of 2% of GDP. The second scenario, the one which was definitely more "pre-federal", consisted in

developing other common policies and would have led to a European budget of between 5 and 7% of GDP. In this case, certain automatic stabilization would have been assured, following the example of what we can observe in already existing federations from the moment the central budget becomes big enough and its expenditure and receipts can easily adapt to the current economic development in different Member States[5]. However, neither of these two scenarios has ever been carried out. At the same time, the way European public finances have developed so far and the way they will probably develop in the future makes us think that no big progress in this domain is possible.

3. Short Assessment of Common Policies

So far, European budgetary expenditures have been dominated by two big common policies which themselves absorb more than three quarters of the budget's total: the CAP with about 47 billion Euros and structural funds with at about 41 billion Euros in 2004. Contrary to the first, rather controversial one which was already deeply reformed and what later helped to decrease slightly the budgetary costs, structural policies have become more important in a spectacular way over the last decade, more exactly since the Maastricht's Treaty and since Central and East European countries – whose economies are far less developed than those of the Fifteen – joined the EU. All that makes structural policies potentially even more important. However, both have been called into question by those who want to limit the size of the European budget while working on some other domains of common policies at the same time.

3.1. Is CAP Threatened?[6]

The CAP was initially conceived to boost the production of the main agricultural products – cereals, milk and beef at the beginning – in a Europe of Six which was at that time very far from food independence. Namely, during the Second World War and in the years after, Europe suffered from food shortage since it was cut off by the "communist block" and the Iron Curtain from its food suppliers, especially from Germany, but, above all, from Germany's agricultural Eastern part. For a long time the CAP rested on two pillars: on one hand, on the pillar of its relatively expensive support of the main productions, expensive in comparison with world prices; on the other hand, it was based on a whole range of "structural" policies of

[5] For these questions see above all Zumer (1998).
[6] In order to learn more about the history of CAP and its first reports, see Le Cacheux and Mendras (1992). For more recent reforms and development, see also Fitoussi and Le Cacheux (2003, ch. 7).

modernization of farms which were supposed to increase their productivity by keeping "the European model" of family farms. This common policy, based on the principle of the single market and financial solidarity allowed at the same time a spectacular growth of production, not only in France, the principle agricultural country of the Europe of Six and later of the Europe of Nine (1972), but also in the rest of the Community, especially in the Netherlands and in Germany; an important restructuring of agriculture and, especially, of farms; an important increase of farmers' income whose standards of living used to be inferior to those of the urban population in the 1950s but got closer to them just after the 1970s. Besides, it was an economical policy for the budget of the Community as long as the Community was showing a deficit in agricultural and food exchanges. Namely, variable importation taxes represented an important and independent resource for the European budget as long as high domestic prices didn't require either stocking or withdrawal from the market or State-aided exportations.

However, this "golden period" of the European agriculture came to its end at the moment it became self-sufficient. Soon it was exceeded by interior prices which were maintained rather high and which was due both to internal political and social reasons and to the monetary irregularities in the 1960s. Then the CAP budgetary costs became higher and higher –- until they represented three quarters of the European budget at the end of the 1980s – while the surplus of butter, milk powder and especially of beef kept on piling up .And, eventually, it became necessary to subsidize internal uses and exportations to the rest of the world.

The reforms undertaken over the last two decades combined in variable proportion the measures of a direct control of the offer – milk quotas since 1984 and fields kept fallow for the most important cereals since 1992 – and a decrease of the prices of support. Their double objective was to dissuade the offer and to encourage both internal and external growth of job opportunities by decreasing the budgetary costs of support and, in principle, the costs of food products for European consumers[7]. As in the 1980s and especially at the period of the appreciation of the US dollar, European agriculture became an important exporter on the world market which was until then dominated by the United States, the US asked and obtained to have the agricultural exchanges included in international business negotiations of GATT for the first time. The Uruguay Round was opened in 1986 and concluded in 1994 by the Marrakech Agreement at which the World Trade Organization was created. That's why, in anticipation of this external liberalization, it was decided to decrease

[7] However, the effects on the consumption prices which have been so often underlined by the partisans of those who claimed the abolition of price pegging are insignificant. One of the reasons is

price pegging and export subsidies and to transform the original system of mechanism of protection thanks to a variable tax on fixed *ad valorem* duties. This trivialization of the international agricultural and food trade is in the heart of new negotiations of the Doha Round whereas the absence of any agreement on these questions, more specifically on the question of responsibility for agricultural dumping practiced by industrialized countries, such as the US and the EU, concerning the maintenance of poverty in the least developed countries[8] is the reason for the failure of the WTO summit in Cancun in September 2003.

At the same time, starting from 1992 onwards two new systems were introduced and progressively they took precedence over the mechanisms of price pegging, notably because they were considered less distorting for the functioning of the markets and therefore more adapted to the WTO precepts (see the ranking list of agricultural subsidies in different colored "boxes"). On one hand, there are measures which encourage extension and environment protection as well as those, starting from the last reform, which are supposed to improve the well-being of animals. On the other hand, there are direct aids for the farmers' income, imagined to compensate decrease of prices and which represent today the biggest part of the European agricultural expenditures.

Thus, different reforms led since 1992 reduced progressively politics of direct public intervention in the market functioning in favor of either measures which encourage methods of different exploitation or of a direct aid for the income of small farmers. The reason for that is that these two methods were considered less harmful for the good market functioning since they were uncoupled from the produced quantities. According to the last reform, the one from June 2003 which should come into effect in 2005, each national government is allowed to fix its own criteria how to allocate direct aids. Thus they could chose between a system of "historical references", a choice closer to the French government, and a "regionalized" system, probably Germany's favorite one.

However, this additional step towards uncoupling turns most European expenditures in the name of CAP into life annuity, financed by tax payers for the benefit of landowners. There is still much inequality in distribution of these "life annuities" and as we cannot always justify them, the position of the partisans of the common policy is becoming weaker and weaker whereas it reinforces those who defend a renationalization of the agricultural politics and which, in fact, is already taking place.

---

agriculture and not very competitive transformation and distribution sectors. See also Laborde and Le Cacheux (2003).

[8] For a more detailed analysis of the negotiations' stakes see Laborde and Le Cacheux (2003).

If the original CAP objectives, notably food self-sufficiency and income equality for farmers and the city population, are not obligatory anymore, at least not in the West[9], what other ambitions could European agricultural policy have? How can a common policy be justified? In a way, we can feel that European consumers-tax payers would rather be for a policy which could guarantee health security of food, protect the environment and look after the well-being of animals. There is no doubt that most Europeans would declare in favor of a policy which would maintain a sufficient density of farms on the whole European territory, avoid a complete agricultural withdrawal, desertification or return of an important part of European regions to their "natural state". The concerned regions are those which have no particular natural beauties and are without any particular local reputation which would be important enough to develop a production whose costs would be higher than world prices. And, finally, we could easily imagine that the agricultural policy has been conceived to boost the economic growth of a strong and competitive European food industry, or even of an industry of some new agricultural products, such as biofuel. All these options as well as some of their combinations[10] are feasible and would probably give a new orientation and a new legitimacy to the CAP. Nevertheless, the current position does not seem to follow this guideline and that's why it can be feared that the future of the European agricultural policy has been threatened despite the Chirac-Schroeder compromise which promises to maintain these expenditures as they are until 2013.

3.2. Should Regional Policies be Renationalized?

When following strictly this line of argument, the Sapir report (2003) defends the idea of suppression of most agricultural costs and pleads for a significant decrease of expenditures of the European budget as far as regional and cohesion policies are concerned. Namely, though the total of these expenditures has dramatically increased over the two last decades, partly to compensate the consequences of the integrations of the weakest economies and, partly, to increase the growth of their economic, social, but, above all, territorial "cohesion", structural and regional policies as well as the policies of cohesion have been severely criticized for, at least, three different reasons. The first reproach to it, which has been very often expressed and from whom even the recent proposal of the Commission to extend the structural aids to new Member States cannot escape, is that it tries to satisfy everybody

[9] Putting both income and productivity of the agriculture of the new Member States from the East on the same level as the old countries would be enough to justify a new agricultural policy. However, we won't deal with it here. For that see Le Cacheux (1996).

[10] Not all of them though because some of them are incompatible. See Le Cacheux and Mendras (1992).

superficially and quickly. Furthermore, it could also be considered as a kind of populism, especially through direct financial links between Brussels and the regions.

The second reproach, perhaps not linked to the first one, concerns small effectiveness of the European structural policies. Actually, the countries which benefited most from the EU financial help in terms of structural and cohesion funds, the so-called four cohesion countries, Spain, Greece, Ireland and Portugal, have experienced a real economic boom, sometimes a spectacular one (Ireland). Besides, regional inequalities haven't really been erased, at least not according to the first scientific evaluations. Thus, Fayolle et Lecuyer (2000) show that the gaps in development between countries decreased but the gaps in development between regions inside the same countries, especially in the poor ones, did not. Consequently, only the richest regions of the least developed countries took advantage of these policies. Why? The authors are convinced that when several factors are added in one single region, it basically works in favor of the richest regions only because they have stronger administrative capacities to launch the projects that potentially could be financed by the European budget. However, we have to look at the results of this study in perspective, first, because we are too close to have a proper view (all the information used here stops with 1996 whereas the growth of cohesions funds started after 1992), and, second, because new studies, based on more sophisticate econometric methods, lead to conclusions full of nuances (Dall'erba and Le Gallo 2003).

On the contrary, the authors of the Sapir report seem to criticize the excess of effectiveness of the European structural policies which could prejudice the economic growth of the whole EU. Thus, at the same time, they justify why they recommend keeping just a small part of it, the part imagined only to compensate the costs of integration and restructuring which follows. So, as they use certain lessons from the "new geographical economics" (Krugman 1991, Martin 1998), the authors of the report think that if the structural European funds actually slow down the trends of economic activities towards agglomerations by opposing to centripetal forces at work in an integrating economic area, they damage the economic growth since the territorial concentration allows the companies to benefit from internal and external economy of scale. Giving up structural policies and giving free rein to centripetal forces would permit to maximize the global growth whose fruit could be later redistributed by the Member States if they wish so.

The conclusions about positive effects of the agglomeration on the growth do not only seem to be weak, both theoretically and empirically, but this recommendation can also be criticized because of its Pareto conception of the underlying redistribution. In the underlying reasoning,

the same as in the classic analysis of the interpersonal redistribution in Pareto, we should first put all the Pareto improvements to good use in order to maximize the well-being of the society and, then, to compensate the losers through fixed redistributional transfers. We know that this purely utility logic is rather controversial. And, probably, just because of the absence of these famous fixed transfers, the modern theory of optimal taxing has clearly proved that redistribution is not an independent function and that it should be taken to arbitration. But, as we don't know the criteria of such an arbitration well enough, we cannot make any conclusions at the moment[11].

4. Two concepts of the European "Budgetary Federalism"

The Sapir report itself suggests limiting the size of the European budget at 1% of the European GNI as well as deploying its expenditures, as we saw it before, to the detriment of the CAP and structural policies and for the benefit of a big European policy of research and development, in favor of the economic growth and which was actually one of the Lisbon objectives. Generally speaking, an opposition between two concepts of the "budgetary federalism" is appearing, still inarticulate but certainly decisive in the future. The first, the classical one, follows the spirit of the MacDougall report and of the existing federations. According to this concept, progressive enlargement of the domain of the European or of the shared competencies, the multiplication and the growth of the European policies generate inescapably a big economic growth at the European level, undoubtedly to the detriment of the national budgets from which a part of their expenses would be progressively reduced through a transfer towards the European scale of common competencies. A very often expressed request to share the competencies between different levels in a more visible way can make us go back to this classical concept.

Another concept seems to be possible, too, and it is perhaps even more adapted to the aspirations of many Europeans and their governments who feel concerned about a too powerful centralization in Brussels and who are not always willing to see a real "federal government" at the European level which could then be given a democratic legitimacy at least equal to theirs and which would then have important financial means. According to this second logic, the European budget could remain relatively small – though perhaps bigger than it is today – and be composed of financial instruments imagined to encourage national

[11] For more detailed critical analysis of the Sapir report and especially of the structural policies, see Le Cacheux and Sterdyniak (2003). Even if they actually helped the poorest regions of the EU, European regional policies could be defended by Rawls' argumentation.

governments to apply themselves the policies which are collectively considered as those which depend on "public goods" as they are defined by the EU. There are different ways to meet these objectives: "additional" subsidies, that is to say those which decrease "tax prices" of certain public expenses, or, on the contrary, taxing certain activities considered by the EU as harmful; the choice of criteria of the public finances – such as Stability pact – by taking into consideration efforts made in favor of certain common objectives, etc. Such a federalism, rather decentralized, could be defined as a "pigouvian[12]" federalism as it is based on independence and clearly understood interests of its members in their research of "common goods". This kind of federalism uses rules and financial instruments of the European budget while respecting the "invisible hand" of the integration in order to correct the incentives for the governments of the Member States in an economic and monetary union[13].

5. Conclusion: About the Right Use of the "Fair Return"

However, all the considerations about the best way to finance previously defined and negotiated common policies and the European collective goods do not seem to count that much in today's context of poor economic performances and strong financial tensions as far as national public domains are concerned. On the contrary, the "accounts logic" (Fayolle and Le Cacheux 1999), which prevailed during the negotiations at the Berlin Summit before the Agenda 2000 was accepted, is still a topical question. Namely, as each government seems to be principally or even exclusively concerned by the problem of minimizing its net contribution to the European budget[14], which cannot but eventually reduce its size and importance, the negotiations are still dominated by the non co-operative strategies of the Member States. However, as long as there is a strong interdependence, these negotiations won't lead to an optimal balance.

[12] In opposition to the Coasian solution of the "classical" federalism and of the theory of the financial federalism where the solution to the problems of overflowing effects and interdependence is centralization.

[13] For a better analysis of some of the incentives, especially in a context of economic stabilization and differences between "big" and "small" countries from this point of view, see Laurent and Le Cacheux (2004) and Le Cacheux (2004).

[14] For an illustration of this assertion referring to the French point of view, see two recently published Parliamentary reports on this subject: Gaillard and Sutour (2004) and Laffineur and Vinçon (2004). Let's say though that the idea of "net contribution" is very debatable in an economically integrated area with strong interdependence. Thus, for instant the Netherlands, one of the big net contributors according to conventional calculation, pay their contribution to the EU budget in the form of customs duties collected on import. But, this amount reveals above all the importance of Dutch ports and the role of their hubs in international trade. Thus, it has little to do with the financial pressure which is put on Dutch consumers and tax payers.

So, even if we haven't developed any of the "federal" logics drafted above and even if we haven't clearly chosen one particular common policy – and that's what the political context doesn't seem to appreciate – we hope that, from a pragmatic point of view, future negotiations on the European budget will be at least an opportunity to use the expenses created by today's common policies as "incentive" or compensatory payments in order to encourage some national governments not willing to accept a particular common decision, to understand that most countries consider it as the best one for all. After all, the reason why structural funds were initially created and why each phase of the European integration was so rich in them, even though their official purposes and uses may have been quite different later on, was to overcome similar hesitations. But if we accept the argument of the "fair return" as a financial leverage in the European budgetary negotiations, it means that at least some of the net contributors are willing to increase the budget. But will the big founding countries be perceptive enough? That is the question.

Bibliography

Begg, Iain (2004), "The EU Budget: Common Future or Stuck in the Past?", *CER Paper*, London, January.

European Commission (1977), *Le rôle des finances publiques dans le processus d'intégration européenne*, a report of a group of experts presided by M. MacDougall, Brussels.

European Commission (2004), "Building our Common Future: Policy Challenges and Budgetary means of the Enlarged Union 2007-2013", COM(2004)101, Brussels, 10th February.

Dall'erba, Sandy and Julie Le Gallo (2003), "Regional Convergence and the Impact of European Structural Funds over 1989-1999. A Spatial Econometric Analysis", mimeo, University of Illinois, Urbana-Champaign, April.

Fayolle, Jacky and Jacques Le Cacheux (1999), "Budget européen: Triomphe de la logique comptable", *Lettre de l'OFCE*, No185, 30th April.

Fayolle, Jacky and Anne Lecuyer (2000), "Croissance régionale, appartenance nationale et fonds structurels européens. Un bilan d'étape", *Revue de l'OFCE*, No73, April

Fitoussi, Jean-Paul and Jacques Le Cacheux (dir.) (2003), *Rapport sur l'état de l'Union européenne 2004*, Paris, Fayard and Presses de Sciences-Po.

Gaillard, Yann and Simon Sutour (2004), « Quels fonds structurels après 2006 ? », Senate's delegation for the EU, *Les Rapports du Sénat*, No204, 2003-2004.

Krugman, Paul (1991), "Increasing Returns and Economic Geography", *Journal of Political Economy*, Vol.99.

Laborde, David and Jacques Le Cacheux (2003), "Price and Welfare Effects of Agricultural Liberalization with Imperfect Competition in Food Industries and Trade", mimeo, ECOMOD Conference, Istanbul, July.

Laffineur, Marc and Serge Vinçon (2004), *Rapport au Premier Ministre sur les futures perspectives financiers 2007-2013*.

Laurent, Eloi et Jacques Le Cacheux (2004), "L'Europe 'Boucles d'or': Trois maximes pour sortir d'une impasse", *Lettre de l'OFCE*, No246, 30th January.

Le Cacheux, Jacques (dir.) (1996), *Europe, la nouvelle vague. Perspective économiques de l'élargissement*, Collection "Références/OFCE", Paris, Presses de Sciences Po.

Le Cacheux, Jacques (2003), "L'agriculture européenne en jachère?", *Lettre de l'OFCE*, No228, July.

Le Cacheux, Jacques (2004a), "Politique économique: les inconvénients de la taille unique", in the file "Comment réveiller la croissance en Europe", *Sociétal*, No43, 1st quaster.

Le Cacheux, Jacques (2004b), "Negotiating the medium-term financial perspectives in the enlarged EU: The future of the European budget", Special number "Elargissement de l'UE", *Revue de l'OFCE*, No89, April.

Le Cacheux, Jacques and Henri Mendras (1992), "Elements pour une nouvelle politique agricole", *Revue de l'OFCE*, No42, October.

Le Cacheux, Jacques and Henri Sterdyniak (2003), "Comment améliorer les performances économiques de l'Europe?", Comments and critics of the "Sapir report", *Revue de l'OFCE*, No87, October.

Martin, Philippe (1998), "Can Regional Policies Affect Growth and Geography in Europe?", *The World Economy*, Vol.21.

Oates, Wallace E. (1972), *Fiscal federalism*, New York, NY., Harcourt Brace Jovanovich.

Oates, Wallace E. (1999), "An Essay on Fiscal Federalism ", *Journal of Economic Literature*, Vol.37, September.

Sapir, André *et al.* (2004), *An Agenda for a Growing Europe*, called also the "Sapir report", Office des publications officielles des CE, Brussels and Luxemburg.

Zumer, Frédéric (1998), "Stabilisation et redistribution: Etats fédéraux, Etats unitaires", *Revue de l'OFCE*, No65.

The Impact of Structural Funds on Iberian Economies

Hugo Zsolt de Sousa[1]

Portugal and Spain joined the European Union (EU) in 1986, culminating a process of long negotiations. Indeed the European community (EC) started formal negotiations with Portugal on October 1978 and with Spain on February 1979. In both countries adhesion to the EC meant a way to consolidate a new and still volatile democracy. The Iberian countries enjoyed a long period of authoritarianism and the EC was seen as a guarantee to ensure a safe path to a more consolidated democracy. Therefore, joining the EU was, for Iberian countries, a more political rather than an economic decision. In this aspect, the Southern enlargement was very successful as both countries today enjoy fully functioning democracies and play an important role in the construction of the EU.

The economic side of the adhesion is also of crucial importance. The Iberian economies were, before enlargement, closed and largely inefficient. Enlargement allowed for important progresses not only in real and nominal convergence but also permitted developments in essential aspects such the increase in competition, infrastructure development, deregulation, foreign direct investment (FDI), etc. An important factor that contributed decisively for this development was the aid received from the structural and cohesion funds.

Structural policy will also play a crucial for the development of the Member States that will now join the EU. Indeed, their socioeconomic development gap towards the actual EU members is high and real convergence will be an objective to be achieved. Structural policy will be decisive in this aspect.

The objective of this paper is, by recurring to existent literature, to assess the impact structural funds had on the Portuguese and Spanish economies and to analyze whether there are important lessons to be taken from these two countries when targeting and implementing structural funds in the Central and Eastern European Countries (CEECs).

1. Structural Policy

[1] Hugo Szolt de Sousa is a Research Fellow at the Research and Policy Group “Notre Europe” (Paris).

The 1987 Single European Act introduced the concept of economic and social cohesion as the basis of European Regional Policy. The objective was to foster a harmonious development within the EU, meaning achieving a high degree of convergence between the richest and the least developed European regions. In 1989 the first Community Support Framework (CSF) was created, culminating in a new planning process that increased policy co-ordination between national authorities and the European Commission. The first Delors package doubled the funding available to Regional Policy. After Maastricht the second Delors package once again doubled the available resources. In between, the Cohesion Fund was created, partly to compensate the EU's least developed countries for the side effects of a European Monetary Union (EMU) which was far from being an optimum currency area. The Agenda 2000 provided a framework to try to answer to not only the consolidation of EMU but also to an enlargement process which was at the time nearly beginning.

The current European Structural Policy aims at reducing disparities between Member States and between regions. It is allocated under objective 1, objective 2 and objective 3 regions, INTERREG III and URBAN II projects.

– Objective 1. It targets regions that have a Gross Domestic Product (GDP) that is below 75% of the Community's average. It absorbs more than two thirds of the structural funds and currently covers some fifty regions that represent 22% of the Union's population.

– Objective 2. It targets regions that usually have a GDP close to the Union's average but that also have structural difficulties, related either to rural, industrial, urban or fisheries problems. It consumes slightly more than 10% of the structural funds.

– Objective 3. It targets investment in human resources and covers regions and along with objective 2 covers regions that do not receive aids under the objective 1. It is financed through the European Social Fund (ESF).

– INTERREG III. It covers interregional, transnational and cross-boarder projects, and targets mostly remote regions or those that share external boarders with the former candidate countries.

– URBAN II. Financed through the European Regional Development Fund (ERDF), it aims at economic and social regeneration in troubled urban areas.

There are four different types of structural funds: the European Regional Development Fund, the European Social Fund, the European Agricultural Guidance and Guarantee Fund (EAGGF or FEOGA as it is known by its French acronym) and finally the Financial Instrument for Fisheries Guidance (FIFG). In addition, the cohesion fund was created and integrated in the Maastricht Treaty with the aim of helping the least prosperous countries catching up with the rest of Europe. Pre-accession funds, namely the Instrument for Structural Policies for Pre-Accession (ISPA), the Special Accession Program for Agriculture and Rural Development (SAPARD) and Phare, were also established with the objective of helping the former candidates in their transition period to the EU.

– The ERDF targets projects aimed at creating jobs. Most development areas are considered, ranging between projects in tourism and culture to transport, rural development, communications technologies, etc.

– The ESF is the oldest available fund as it was first established in the Treaty of Rome. It aims at fighting unemployment, namely by acting as financial support to the implementation of the European Employment Strategy (EES). Thus, its main objective is to improve the employability of those that are particularly lagging behind (*i.e.* long term unemployed, youth unemployment and so on).

– The EGGAF finances the Common Agriculture Policy (CAP) and the FIFG assists the fisheries sector.

In terms of financing, objective 1 includes projects that relate to all the above mentioned funds. Objective 2 includes only the ERDF and the ESF, and objective 3 only refers to the latter.

2. The Evolution of the Portuguese and Spanish Economy

Portugal has been diverging from the EU since 2002. This tendency is likely to continue until 2006. This reflects partly the adjustments the country is going through, namely as a consequence of the structural reforms it has embarked upon, and also the abandoning/temporary suspension of major public investment projects such as the new airport, the fast speed train and so on. In addition, it reflects the side affects of the one off measures undertook by the Portuguese government to come back into line with the 3% deficit that inevitably had a negative impact on demand, such as a rise in indirect taxation

and the introduction of tolls in motorways along with the above mentioned suspension of major public investments. Moreover, Portugal has seen a drop of around 70% of FDI last year along with a delocalization process of firms towards the CEECs and Asia. This is due to the low labor and social protection costs associated to these countries as well as higher educational standards, at least in what the CEECs are concerned, in a process which is similar to the one which led to high inflows of FDI to the country from the 1980's until the mid-1995's, where foreign companies were attracted mainly to the low labor costs that existed in Portugal. Both lower demand and delocalization of companies have contributed to the increase in unemployment in recent years (it increased more than 50% between 2000 and 2003 and that increase is likely to continue until 2005).

Graph 1. Annual Resources of the Structural and Cohesion Funds
(Million Euros at 1999 prices)

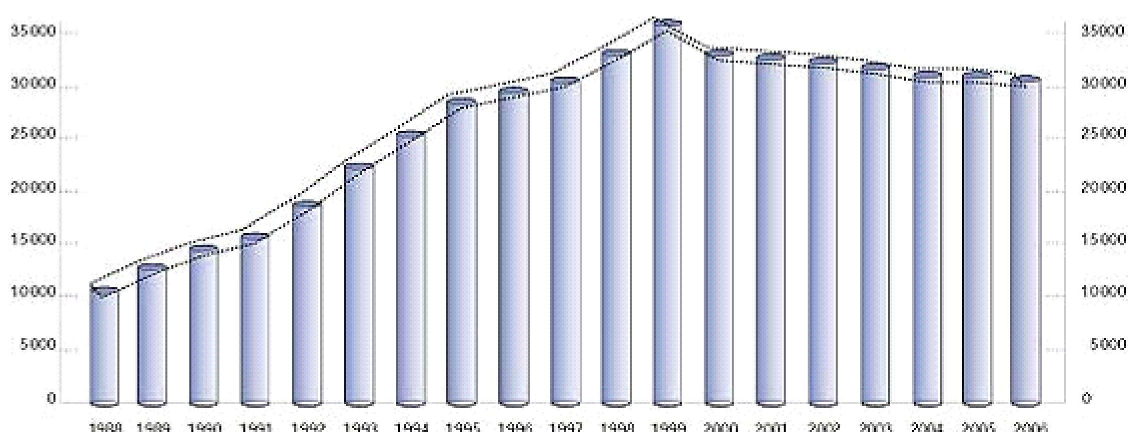


Table 1. GDP in Purchasing Power Parities (EU 15 = 100)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
EU (15)	100	100	100	100	100	100	100	100	100	100	100	100
Euro zone	100.9	100.9	100.6	100.1	100.2	100.2	99.9	98.6	98.2	97.9	97.8	97.7
Euro zone (12)	99.7	99.6	99.3	98.9	99	98.9	98.7	98.6	98.2	97.9	97.8	97.7
EU+ACC					90.8	90.9	91	91.3	91.4	91.7	91.8	92
Belgium	108.5	108.5	107.2	106.6	105.4	105.3	106.4	107	106.5	106.4	105.4	104.9
Denmark	112.6	112.8	113.9	114.4	113.4	115.8	115.5	115.4	112.3	112.7	112.6	112.4
Germany	108.5	107.8	107.1	105.1	103.9	103.1	102	100.5	99.6	99.1	99.1	98.5
Greece	66.5	65.1	64.8	65.5	65.2	65.3	66	67.2	70.9	73.6	75.6	76.6
Spain	78.6	79	79.5	79.7	81	83.5	83.4	84.3	86.1	87.4	88.1	88.9
France	104.8	104	103.4	104	104.1	103.9	103.8	104.8	104.6	103.6	103.1	103
Ireland	84.1	89.7	93.7	102.3	106.2	111.2	115.1	117.7	125.5	122	122.4	124.2
Italy	103.5	104.2	104	102.5	103.2	101.9	101.3	100.1	98.4	98.5	98.3	98
Luxemburg	164.8	161.4	160.9	167.6	175.2	189.2	198.7	194.3	188.9	186.6	186.3	187.6
Netherlands	108.2	108.6	109	109.8	110.1	109.7	110.7	113.3	111.5	109.5	107.6	106.9
Austria	115.2	114.5	114.9	113.3	112.9	113.7	114.4	112	111	110.9	110.4	110.1
Portugal	64.9	66	66.2	67.2	68.5	70.2	70.4	70.6	70.9	69.4	68.5	68
Finland	94.6	95.5	95.8	100.6	103.2	101.5	104.1	104.2	101.8	101.1	100.9	100.7
Sweden	105.4	106.8	106.5	105.6	104.5	107.7	109.1	103.2	104.6	104.5	104	103.6
UK	99.4	99.9	101.2	103.6	103.4	103	103.9	105.1	107.4	108.9	109.8	110.5

Source: European Commission.

Table 2. Inflation Rate

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
EU (15)	4	3.4	2.8	2.8	2.4	1.7	1.3	1.2	1.9	2.2	2.1	2
Euro zone	3.6	3.3	2.7	2.4	2.2	1.6	1.1	1.1	2.1	2.3	2.3	2.1
Euro zone (12)	3.8	3.4	2.8	2.6	2.3	1.7	1.2	1.1	2.1	2.4	2.3	2.1
Belgium	2.3	2.5	2.4	1.3	1.8	1.5	0.9	1.1	2.7	2.4	1.6	1.5
Denmark	1.9	0.9	1.8	2	2.1	1.9	1.3	2.1	2.7	2.3	2.4	2
Germany					1.2	1.5	0.6	0.6	1.4	1.9	1.3	1
Greece					7.9	5.4	4.5	2.1	2.9	3.7	3.9	3.4
Spain		4.9	4.6	4.6	3.6	1.9	1.8	2.2	3.5	2.8	3.6	3.1
France	2.4	2.2	1.7	1.8	2.1	1.3	0.7	0.6	1.8	1.8	1.9	2.2
Ireland					2.2	1.2	2.1	2.5	5.3	4	4.7	4
Italy	5	4.5	4.2	5.4	4	1.9	2	1.7	2.6	2.3	2.6	2.8
Luxemburg					1.2	1.4	1	1	3.8	2.4	2.1	2.5
Netherlands	2.8	1.6	2.1	1.4	1.4	1.9	1.8	2	2.3	5.1	3.9	2.2
Austria	3.5	3.2	2.7	1.6	1.8	1.2	0.8	0.5	2	2.3	1.7	1.3
Portugal	8.9	5.9	5	4	2.9	1.9	2.2	2.2	2.8	4.4	3.7	3.3
Finland	3.3	3.3	1.6	0.4	1.1	1.2	1.4	1.3	3	2.7	2	1.3
Sweden	1.3	4.8	2.9	2.7	0.8	1.8	1	0.6	1.3	2.7	2	2.3
UK	4.2	2.5	2	2.7	2.5	1.8	1.6	1.3	0.8	1.2	1.3	1.4

Source: European Commission.

In Spain, the situation is different. Spain has kept converging with the EU average, achieving not only lower unemployment rates but also a budget surplus. By 2005 Spain should be at nearly 89% of the EU's GDP in Purchasing Power Standards (PPS) whilst Portugal will be only at 68%. This means that the differential between both countries would have increased significantly. Indeed, in 1994 Portugal had 64.9% of the EU's GDP, a figure likely to increase to 68% by 2005 and Spain had 78.9% of the EU's average and should reach 88.9% in 2005. The gap between both countries, considering the EU's average should increase to twenty points compared to fourteen points in 1994.

Hence, the adhesion of Portugal to the EC traduced in an inflexion point in what gross domestic product is concerned. Indeed, during the five subsequent years to the Portuguese adhesion, Portugal had an annual growth rate of 0.9%, which was 0.7% less than the Community average. This was due to political instability and to the austerity programs taken, namely the recurrence to the International Monetary Fund (IMF) support in 1982 which was seen as the only was to stabilize a country where inflation was achieving the 30% figure. In 1985, inflation had been reduced to less than half of that figure but the economic situation remained difficult and fragile.

These figures changed dramatically after 1986. Between 1986 and 1991, Portugal grew at a pace of 5.5% per year, which was significantly above the EC's yearly average. The GDP per capita measured in Purchasing Power Parity (PPP) increased from 54%, of the Community's average in 1986 to around 65% in 1991. Currently it is at 70% although it is expected to decline slightly until 2005. This success was due to a policy of structural reforms (such as launching privatizations), to a policy oriented towards macroeconomic stability, to increased

political stability and to the financial aid that started to come from the European Community as a result of the Portuguese adhesion. Prices have also significantly converged. The price differential towards the EU was more than 15 points before the Portuguese adhesion, decreased to six points during the course of the first Community Support Framework and to less than two points by the end of the second Community Support Framework.

Table 3. GDP in Quantity

Time Period	Annual change rate in %		Differential
	Portugal	EU15	
Pre-CFS I (1986-1988)	6.0	3.3	2.7
CFS I (1989-1993)	2.6	1.8	0.8
CFS II (1994-1999)	3.8	2.3	1.5

Source: DPP, Ministry of Finance, Portugal.

As can be seen Portugal has significantly grown at a higher rate than the EU during the periods of both CFS. Naturally, the only way to catch up with the rest of the EU is by having faster growth rates, something that has mentioned before, has not been occurring in recent years.

Nevertheless, it has to be said that the Iberian convergence process was rather successful. Both countries have been growing faster than the European average and have significantly converged since their adhesion. Structural funds are forecast to have highly contributed to this success and the recent GDP divergence that has been occurring between Portugal and the rest of the EU is not to be attributed to any structural policy failure but rather, as argued before, to the side effects of some policies taken.

In what regards productivity levels, Portugal continues to have the lowest value in the EU. In 1993, Portuguese productivity was at 56.5% of the EU average and in 2003 it is estimated to 63.9%, already lower than in Slovenia and Hungary. This is explained by the high concentration of labor intensive industries associated with the lowest educational and qualification levels in the EU. In fact, most of the employment generated in Portugal during the 1980s and 1990s was based on low productivity industries, particularly in the textiles sector. A significant amount of the FDI was also related to that activity.

In Spain, labor productivity has not varied significantly since the beginning of the 1990's and it is nearly at the EU average.

Table 4. Labor Productivity per person employed

GDP in PPS per person employed relative to the EU-15 (EU 15=100)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
EU 15	100	100	100	100	100	100	100	100	100	100	100
Belgium	123.4	124.3	120.4	118.9	118.2	116.9	117	118.2	118.5	118.9	118.5
Denmark	93.2	94.2	94.1	94.7	95	94.5	97.1	98.2	98.9	97.2	98.3
Germany	99.3	98.9	98.9	98.9	98	97.4	96.9	95.9	95	94.9	95.5
Greece	80.7	78.5	78.2	78.8	82.5	78.1	79.6	81.6	84.4	89.1	91.9
Spain	96.6	96.6	95.9	95.5	93.8	93.4	94.9	93.7	94.1	95.5	95.8
France	116.5	115.3	114.4	113.8	115.1	115.7	115.4	114.8	115.4	114.8	113.6
Ireland	102.3	101.9	105.6	107.4	112.8	111.1	112.6	114.5	116.3	124.1	120.4
Italy	111.5	112.4	114	113.4	112.3	113.8	112.9	112.1	109.8	106.3	106.1
Luxemburg	135.3	133.1	129.7	128.0	131.9	135.8	143.7	147.3	138.3	131.7	129.7
Netherlands	100.2	99.5	98.7	97.3	96.1	96	95.2	96.2	98.2	96.3	95.6
Austria	97.4	97.2	97.3	98.4	97.4	97.7	98.6	100.3	98.6	98.2	97.9
Portugal	56.5	56	57.6	61.6	62.2	62.9	64.5	64.6	64.7	65	63.9
Finland	97.3	99.7	99.7	99.1	101.5	104	101.5	103.7	103.3	100.3	99.6
Sweden	93.6	95.6	96.5	97.3	98.4	97.5	99.9	100.6	97.2	95.8	96.2
UK	88.5	89	89.3	89.4	90.7	91.1	91	92.3	94.1	96.3	97.2
Poland				42.3	40	42.5	45.8	47.6	47.9	48.8	50.3
Hungary			53.7	53.7	55.2	56.2	56.3	57.6	60.9	62.6	64.2
Slovenia			58.2	60.3	62.4	63.9	66.5	65.1	66.8	68.4	69.5

Source: European Commission.

High levels of unemployment have always been a key problem of the European economy. It ranges between 3.7% in Luxemburg and the 11.3% in Spain although the situation will become more asymmetrical after enlargement as Poland and Slovakia have unemployment rates that almost reach 20%. Other countries with high unemployment rates include Lithuania (12.7%), Latvia (10.5%) and Estonia (10.1%).

Table 5. Unemployment Rate

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
EU 15	8.9	10.1	10.5	10.1	10.2	10	9.4	8.7	7.8	7.4	7.7	8
Belgium	7.1	8.6	9.8	9.7	9.5	9.2	9.3	8.6	6.9	6.7	7.3	8.1
Denmark	8.6	9.6	7.7	6.7	6.3	5.2	4.9	4.8	4.4	4.3	4.6	5.6
Germany	6.4	7.7	8.2	8	8.7	9.7	9.1	8.4	7.8	7.8	8.6	9.3
Greece	7.9	8.6	8.9	9.2	9.6	9.8	10.9	11.8	11	10.4	10	9.3
Spain	14.9	18.6	19.8	18.8	18.1	17	15.2	12.8	11.3	10.6	11.3	11.3
France	10.0	11.3	11.8	11.3	11.9	11.8	11.4	10.7	9.3	8.5	8.8	9.4
Ireland	15.4	15.6	14.3	12.3	11.7	9.9	7.5	5.6	4.3	3.9	4.3	4.6
Italy	8.7	10.1	11	11.5	11.5	11.6	11.7	11.3	10.4	9.4	9	8.7
Luxemburg	2.1	2.6	3.2	2.9	2.9	2.7	2.7	2.4	2.3	2.1	2.8	3.7
Netherlands	5.3	6.2	6.8	6.6	6	4.9	3.8	3.2	2.9	2.5	2.7	3.8
Austria		4	3.8	3.9	4.4	4.4	4.5	3.9	3.7	3.6	4.3	4.4
Portugal	4.3	5.6	6.9	7.3	7.3	6.8	5.1	4.5	4.1	4.1	5.1	6.4
Finland	11.7	16.3	16.6	15.4	14.6	12.7	11.4	10.2	9.8	9.1	9.1	9
Sweden	5.6	9.1	9.4	8.8	9.6	9.9	8.2	6.7	5.6	4.9	4.9	5.6
UK	9.8	10	9.3	8.5	8	6.9	6.2	5.9	5.4	5	5.1	5
Poland						10.9	10.2	13.4	16.4	18.5	19.8	19.2
Hungary					9.6	9	8.4	6.9	6.3	5.6	5.6	5.8
Slovenia					6.9	6.9	7.4	7.2	6.6	5.8	6.1	6.5

Source: European Commission.

Portugal has been enjoying low unemployment rates despite the recent increases. However, as seen, this hides a picture of a rather low productive labor force where most jobs are manually oriented. A reform of the labor market along with a change in the specialization

patterns of the economy is essential; otherwise the unemployment rate is likely to go up as a consequence of further delocalizations that will inevitably take place to other low wages countries but also due to a necessary change in the development-pattern of the country. In Spain, following a high growth period as well as labor market reforms, the unemployment rate has been decreasing. Despite being the highest among all EU countries it dropped from nearly 19% of the labor force in 1993 to 11.3% presently, therefore significantly converging with the EU average.

In conclusion, and despite the negative impact the current economic downturn had on the Portuguese economy (in 2003, according to Portuguese official data, there was a negative growth of 1.3%), it can be said that both Spain and Portugal converged with the EU. Convergence is a gradual and long-term process. The impact structural funds have on that convergence process is what will be assessed next.

3. The Contribution of European Funds

Portugal has highly benefited from the structural funds. Indeed, both the mainland and the islands (Azores and Madeira) are listed under objective 1, the only exception being the region of Lisbon that since 1999 enjoys a favorable phasing out period.

Table 6. Structural Funds Assistance to Portugal

CSF I (1989-1993)	9,458 million ECUs (1994 prices)
CSF II (1994-1999)	17,593 million ECUs (1994 prices)
CSF III (2000-2006)	23,599 million Euros (at 1999 prices)

Source: Bacelar (2003).

According to the European Commission, around 40% of the Portuguese GDP convergence with the EU average can be attributed to the structural funds. This reflects both direct effects that arise from investments in infrastructures, such as motorways, health centers and indirect effects as the structural funds helped to develop the country's infrastructures thus making it more attractive to FDI. They also fostered private investment through funds given to SME.

Hence, structural funds helped to shape the Portuguese economy both directly and indirectly. The most visible action of the importance of the structural funds in Portugal and Spain is the development in transport networks. In Portugal, connection times between Lisbon and Oporto diminished by around 30% – 40% of this can be attributed to the structural funds.

In addition, structural funds are also responsible for 10% of the development that took place in the field of telecommunications, for example in the number of phone lines and also in digitalization.

Furthermore, structural funds have significantly contributed to the investment rise in education and human resources. Indeed, during the second Community Support Framework, nearly 2 million people were covered by projects co-financed by the European social fund with the aim of increasing employability and of raising educational and training standards. The overall aim was to increase the national productivity level.

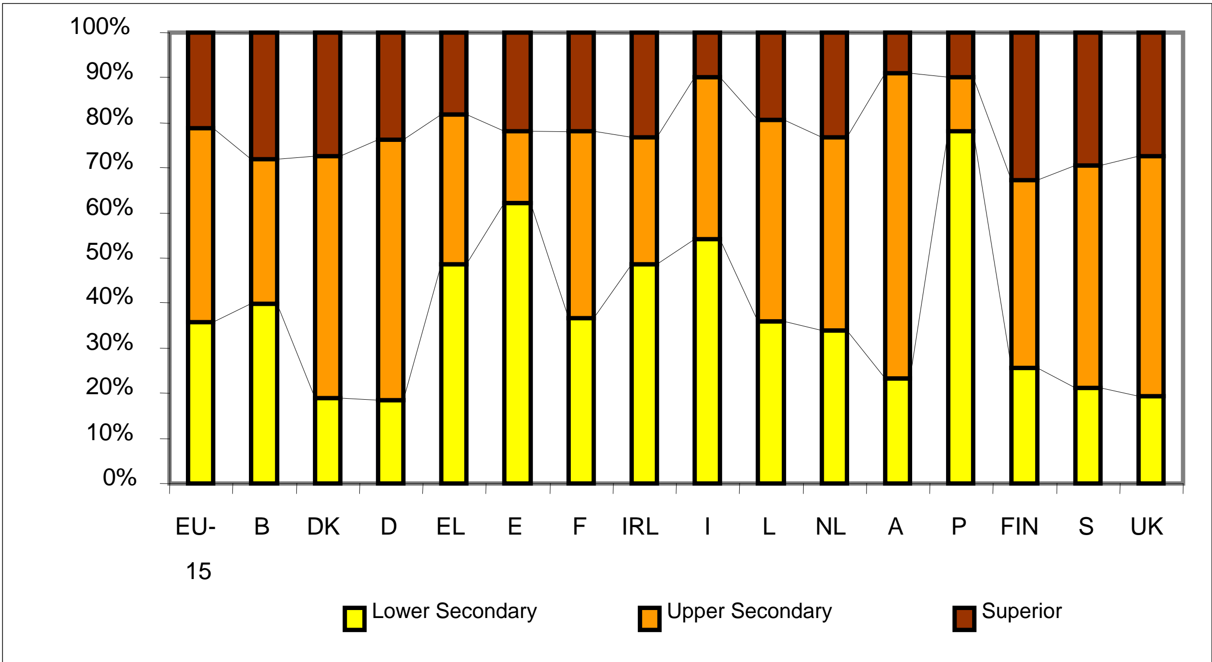
Table 7. Number of People Directly Involved in Training Activities Sponsored by Structural Funds

Policy Action	Number of people covered
Teachers training	253,000
Training of young people in occupational schools	28,652
Employment promotion activities	250,000
Training of Civil Servants	191,000
Initial qualification measures	136,000
Lifelong learning measures	270,000

Source: Bacelar (2003).

The relevance of the structural funds in what education is concerned is not arguable. It has contributed to the increase of qualifications of the active population, thereby increasing employability. However, the practical results of this investment are still not fully satisfactory.

Graph 2. Percentage of Population per Education Level (1999)



Source. European Commission.

Portugal continues to have very low education standards when compared to not only with the present but also the future Member States, especially very high schooling dropping rates.

Portugal has the highest percentage of the population holding only the lower secondary or less and the least holding the upper secondary. In Spain the situation is similar but the problem is nonetheless less significant than in Portugal. As mentioned, this situation, along with the concentration of labor intensive industries in detriment of high technology oriented investments, helps to explain the low convergence in terms of productivity between Portugal and the EU that has been occurring in recent years, despite the fact that increasing productivity has been the main policy objective when designing the CSF II.

4. Overall Impact of CSF I, CSF II and Estimated Impact of CSF III

As mentioned before structural funds have been playing a crucial role in the development of the Iberian economies. From a macroeconomic perspective, the first Community Support Framework (1989-1993) is estimated to have contributed 0.7% to the Portuguese annual growth rate during that period. In addition, 80,000 of the new jobs created can be directly attributed to the structural funds.

For the second Community Support Framework the main priority continued to be investing in infrastructures but a strong emphasis was placed on increasing productivity. In order to do that, investments to improve the population’s low schooling level, as well as reducing the country’s illiteracy rate (11% in 1991) were a priority.

Thus, the second Community Support Framework contributed to an additional increase on the Portuguese growth rate of 0.5% per annum. 106,000 jobs were created through the direct influence of the structural funds, implying an estimated reduction in the unemployment rate of around 2%, during the whole period. The impact of the structural funds is also considerable on both private and public consumption (4% and 2% respectively). Real wages have also increased.

In Spain the situation is rather similar. De la Fuente (2002) has estimated that structural funds had a considerable impact on the Spanish economy. Indeed, the 1994-1999 Community Support Framework added one point per year to output growth and also contributed 0.4 point yearly to employment growth.

Moreover, he argued, “in the medium run, the accumulated impact on employment exceeds 300,000 new jobs, and the contribution to the growth of output in the less favored regions exceeds six percentage points. This amounts to 20% of the initial gap in income per capita between the objective 1 regions and the rest of Spain”. It is also estimated that the contribution of the Community Support Framework to the Spanish objective 1 regions in terms of gross growth is around 15%, exceeding the 20% in the regions of Asturias and Galicia.

5. Lessons from the Iberia to Future Member States

From May 1st 2004 the EU will be enlarged to 25 Member States. By 2007, it could become a union of 27 members and Croatia is also on the loop to join soon. This means widening the EU territory by 34% with an increase in population of around 28%. On the other hand, GDP per capita will decrease 15%. In addition, most of these countries are largely agricultural (Poland, Romania, Latvia and Lithuania). They also have large regional disparities, although no larger than in the current EU (DIW and EPRC 2001). Regional policy however has not been a priority in recent years and the high influxes of FDI that have been occurring have contributed to rise GDP per capita but also to increase regional disparities. As an example, in Estonia, the Tallin area concentrates 80-90% of foreign investment and around 40% of all registered enterprises. Budapest accounts for two thirds of the Hungarian FDI and 35% of the service sector employment. The situation is similar in Slovakia (DIW and EPRC 2001). In spite of strong regional differences, it is when looking at GDP per capita that the situation differs the most when compared with the EU as it stands today. Just as an example, the poorest EU region (Ionios in Greece) has around 43% of the EU’s GDP which is similar to the Czech Republic and Hungary which are two of the most developed CEECs (DIW and EPRC 2001). Moreover, most countries still enjoy today a lower GDP than they had in 1989. Hence, this will imply new challenges to the European cohesion policy.

When taking the example of the Iberian countries, it should be borne in mind that the situation is different. Firstly, both countries were more developed when they started to receive financial aid then their counterparts and had a larger absorption capacity. Secondly, and despite having lived under totalitarian regimes, they had never experience communism. This is relevant in what institutions and their readiness to deal with the complexity of structural funds is concerned.

Undoubtedly, one of the biggest challenges to the new comers will be institutional. New methods and new procedures will have to be learnt. Thus it will be important to channel

funds to training for civil servants as civil servants have a crucial role not only in administrative terms but also in what the selection of projects is concerned.

An appropriate selection of projects is also essential. They should obey to a long-term strategy and to clear goals and objectives that countries want to reach. Targets should be as clear as possible so that efficient assessments can be easily made.

Structural funds should also be used to provide adequate training to entrepreneurs. Indeed, one of the main problems in Portugal was, and to some extent still is, the lack of focus on the long term. This originates less planning and eventually less efficient projects presented which inevitably leads to productivity losses.

Countries should also use structural funds to reduce regional disparities. In Spain, for example, peripheral regions such as Galicia and Asturias have been receiving proportionally more than their Portuguese counterparts. As a consequence, more regions in Spain have dropped out from objective 1, while in Portugal that situation only occurred in the Lisbon area. Indeed, the development dynamics has led to strong agglomeration effects in the largest local metropolitan areas, even more than on boarder regions. Regional asymmetries are high. The advantage of investing in less developed regions, along with the former industrial areas that are now virtually abandoned is that CEECs would be looking at a more sustainable development. If however, projects are focused only in the regions with higher population density than these countries are likely to have high flows of migration from high unemployment regions to capitals in a process likely to cause not only labor market distortions but also environmental and congestion problems. A sustainable development, as defined in Gothenburg should be a priority.

Finally, another important aspect is to have an efficient control over what subsidies are attributed and how they are implemented so as to prevent abuses, which was particularly seen in both Portugal and Spain during the first Community Support Framework.

6. Conclusion

The objective of this paper was to briefly review the main aspects of structural policy and how that has been affecting the Iberian economies. In order to do that we looked at the process of real convergence and to the macroeconomic evolution of both economies and from there assessed the forecast contribution structural funds gave to the Iberian

convergence process. The main conclusion is that both convergence processes have been successful, especially when assessing GDP growth rates. Finally we look at some possible lessons that can be derived from the Iberian case and that might be relevant to the future Member States. Bearing in mind the structural differences that exist between on the one hand, Iberia and the CEECs and on the other hand among CEECs themselves, each Member State will have to carefully assess their domestic priorities that will need to be tackled. In Slovakia, the high unemployment rate is a cause of concern while in Poland attention will have to be given not only to this problem but also to the large rural areas.

In any case, combating regional disparities, prepare domestic institutions to deal with the complexity of the structural funds mechanism, pay close attention to monitoring and programs controlling and make a careful selection of projects are essential aspects.

References

Bacelar, J. (2003), Seminar Presentation, Lodz, Poland.

Carvalho, C.A. (2001), « A convergência real Portugal e a União Europeia », Department of prospective and planning, Ministry of Planning, Lisbon.

De la Fuente, A. (2003), *El impacto de los fondos estructurales: convergencia real y cohesion interna*, Lisbon, Instituto de Analisis Economico.

De la Fuente, A. (2002), *Does cohesion policy work? Some general considerations and evidence from Spain*, Lisbon, Instituto de Analisis Economico.

Department of Prospective and Planning, Ministry of Planning (2003a), « QCA III, Impacto macroeconomico avaliação intercalar », Lisbon.

Department of Prospective and Planning, Ministry of Planning (2003b), « Acompanhamento do processo de convergência com a União Europeia », Lisbon.

Department of Prospective and Planning, Ministry of Planning (2001), « Impacto macroeconomico do quadro comunitario de apoio (1994-1999) », Lisbon.

Department of Prospective and Planning, Ministry of Planning (1999), « Portugal no contexto da UE dinâmica de convergência », Lisbon.

European Commission (2004), « Third report on economic and social cohesion », Brussels.

European Commission (2001), « Second report on economic and social cohesion », Brussels.

European Commission (1996), « First report on economic and social cohesion », Brussels.

Mayhew, A. (2003), « The financial and budgetary impact of enlargement and accession », Sussex European Institute, *SEI Working Paper*, No.65.

Royo, S. (2003), « Lessons for post-communist Europe from the Iberian integration into the EU after sixteen years », *Central and Eastern Europe Working Paper*, No.57, Harvard University.

European Union's Website, <www.europa.eu.int>.

Regional and Cohesion Policy After Enlargement

MAXIME LEFEBVRE AND MAGDALENA WERPACHOWSKA[1]

Regional and cohesion policy is the expression itself of the financial solidarity between the EU Member States. It represents the second biggest budgetary expenditure of the EU – the biggest one is common agricultural policy – and it amounts to a little bit less than 0.4% of the GDP of the EU. Its development was particularly strong after Greece, Spain and Portugal – countries whose level of development was lower than the Community's average – had joined the EU.

Today, the regional and cohesion policy is facing a challenge – the challenge of the enlargement. The regions of the EU of 15 are already distinguished by strong disparities in development. Disparities in revenues and employment, both among the countries and among the regions, are growing with the EU enlargement in 2004. In addition to that, new Member States are planning to benefit from the important Community funds as quickly as they can, if possible starting from the period of 2004-2006.

The Commission's presentation of its proposals for the financial prospects in 2007-2013 and of its third report on the economic and social cohesion has launched a debate on the future of the cohesion policy. And what's at stake is at the same time the level and the concept of this policy, its role in the EU budget as well as its impact on the economic, social and territorial balance of Europe.

Apart that, the cohesion policy is being backed by the project of the constitutional treaty which makes the "territorial cohesion" a competence shared by the Union for the same reason as the economic and social cohesion.

[1] Maxime Lefebvre is the head of European Affairs at IFRI. Magdalena Werpachowska has a Master of Romance philology from University of Warsaw and a Master of the Institut d'Etudes Politiques of Paris.

1. Regional and Cohesion Policy Today

Since 1957 the Preamble to the Rome Treaty has been stating as objective limiting the gaps in development between regions. However, the creation of the European Social Fund (ESF) corresponds better to the logic of the sectorial policy than to the reduction in regional disparities. Likewise, even though the European Agricultural Guidance and Guarantee Fund (EAGGF or FEOGA as it is known by its French acronym), was created in 1962 within the framework of the Common Agricultural Policy (CAP), its structural vocation, through the section of "Orientation", was not confirmed before the 1970s.

As regional disparities were becoming more and more important after the first enlargement of the EEC, a decision to establish a Community policy in order to fight them was made at the Summit of Paris in 1972. The oil crisis and its economic consequences, especially the rise of joblessness, reinforced that decision so that in 1975 an instrument of financing, the European Regional Development Fund (ERDF), as well as one consulting body, a committee for regional policy, were created. This policy enters the EEC Treaty with the Single European Act under the name of "economic and social cohesion" (1986). Its objective is to "promote a harmonious development of the whole Community" – and, above all, to reduce the "gap between the levels of development in different regions as well as the backwardness of the least assisted regions or islands, including some rural zones" (article 158). To meet these objectives, the Community works together with the Member States "through funds with structural objectives (European Agricultural Guidance and Guarantee Fund [FEOGA], section "Orientation"; European Social Fund [ESF]; European Regional Development Fund [ERDF]) from the European Investment Bank (EIB) and from some other financing instruments" (article 159).

Within the framework of the Maastricht Treaty (1992), traditional instruments of regional policy were completed by a "Cohesion fund". This fund is made above all for the Member States whose GDP per capita is less than 90% of the Community average and who already put in place a program whose objective is to satisfy the economic criteria of convergence. In other words, today it means Spain, Portugal and Greece. On the other hand, Ireland had such a strong growth that it lost the right to benefit from the cohesions funds after the half-way revision of the structural funds for 2000-2006. The cohesion funds help finance the projects concerning the environment as well as the transeuropean network of transport infrastructure.

The aim of the *ESF* is to promote employment and geographical and professional mobility of the workers as well as to facilitate adaptation to industrial changes and to the development of the systems of production, especially through professional training.

The aim of the *ERDF* is to help correcting the reasons for the main regional imbalance through its participation in development and structural adjustment of less developed regions and restructuring of the industrial regions in decline.

FEOGA, section "Orientation", helps rural development and the adjustment of the agricultural structures. It mainly intervenes in developing regions.

Financial Instrument for Fisheries Guidance (FIFG) helps establishing a balance between the halieutic resources and their exploitation, reinforces the competition of the exploiting structures, improves the supply and, finally, revitalizes the concerned zones.

The instruments and the means allocated to the regional policy for the 2000-2006 period were defined in Berlin by the Council of Europe in March 1999. The subsidies planned for this policy for the 2000-2006 period were fixed at 213 billion Euros (price of 1999). After the financial prospects were adapted to take into consideration the enlargement of 2004, the allotted budget was increased to 235 billion Euros (price of 1999, for the EU of 25). In current prices, new credits allotted to the EU are stabilizing at 261 billion Euros for the same period. The Structural fund and the Cohesion fund represent at about 0.4% of the GDP of the EU. For the 2000-2006 period, the amounts transferred to the objective 1 regions represent 0.9% of the Spanish GDP and more than 2.5% of the Greek and Portuguese GDP.

Whereas the cohesion fund is meant for the poorest EU Member States whose GDP per capita is less than 90% of the Community's average, all the Member States are eligible for the structural funds. Thus, Spain is the biggest beneficiary of the structural actions for 2000-2006. The allowance planned for this country is 56.2 billion Euros in prices of 1999, that is to say 26.4% of the allotted budget for the EU of 15. The second biggest beneficiary is Germany for whom the structural funds represent 29.7 billion Euros (prices of 1999), that is to say 14% of the allowance planned for the EU of 15.

The table 1 shows the way the credits of structural actions (structural funds and cohesion funds) are distributed.

As far as regional policy is concerned, France is a net contributor for the 2000-2006 period, that is to say that its returns are lower than its contribution. Thus France's financial participation has been estimated at 40.6 billion Euros whereas its returns amount to 15.7 billion Euros. Therefore, the net debit balance for France is 24.9 million Euros (prices 1999).

Table 1. Main Beneficiaries of Credits for the 2000-2006 Structural Actions

Country	Amount (million Euros 1999)		Amount (million Euros 2004)		Part of the total	
	Total amount	Annual amount	Total amount	Annual average	EU of 15	EU of 25
Spain	56,205	8,029	62,091	8,870	26.40%	23.90%
Germany	29,764	4,252	32,862	4,695	14.00%	12.70%
Italy	29,656	4,236	32,743	4,678	13.90%	12.60%
Greece	24,883	3,555	27,483	3,926	11.70%	10.60%
Portugal	22,760	3,251	25,139	3,591	10.70%	9.70%
United Kingdom	16,596	2,371	18,324	2,618	7.80%	7.10%
France	15,666	2,238	17,297	2,471	7.30%	6.70%

Source: Report to the French Prime Minister (2004).

2. Effects of Convergence of the Regional Policy

Between 1994 and 2001 the growth of the GDP, employment and productivity was significantly superior in the cohesion countries (Greece, Spain, Ireland, and Portugal) than in the rest of the Union. Structural interventions stimulated the growth by increasing both demand and offer through improvement of infrastructures and human capital. In addition to that, the increase of manpower productivity made manufacturing productivity grow, too.

The interventions of the Structural funds stimulated also the growth of trade between the cohesion countries and other parts of the Union while economic integration was becoming stronger and stronger. During the last decade the trade between the cohesion countries and the rest of the Union doubled. According to the Commission's estimations, at about a quarter of the expenditure of objective 1 from the structural funds comes back to the rest of the Union as orders, especially orders of machines and equipment, but also as the participation of companies from other Community states in infrastructure markets or works undertaken thanks to this fund. Such a return is particularly important for Greece (42%) and Portugal (35%) and slightly smaller for new German Länder (18.9%), the Italian Mezzogiorno (17.4%) and Spain (14.7%). In all, the importation from the non-EU countries represents 9% of the expenditure of the funds for objective 1. The biggest importation concerns Spain (13.2%) and Ireland (11.1%).

2.1. The Irish Example

The Irish GDP per capita increased almost four times more quickly than in the rest of the Union (8% per year in Ireland against a little bit more than 2% in the Union). Consequently, in

2001 the GDP per capita (in terms of PPP) was 17% better than the average of EU of 15. The successful convergence of this country was due not only to an intelligent use of structural funds but also to healthy macroeconomic policies and application of a favorable tax system which attracted numerous direct investments from abroad. Thus, the domains turned towards exportation as well as those with skilled labor – state-of-the-art technology, pharmaceutical products and services – reinforced the Irish economy.

The growth of employment was significant, too. Whereas the rate of employment in Ireland was 54.9% in 1996 (against 59.9% on average in EU of 15), in 2002 it was 65% which was slightly higher than the average of EU of 15 (64.2%). This growth of employment was accompanied by an increase of manpower productivity of 4% per year, in other words three times as much as the average of EU of 15.

2.2. Spain, Greece, Portugal

In these three cohesion countries, the growth of the real GDP per capita was much smaller than in Ireland, though it still remained superior to the one observed in the rest of the EU since the beginning of the 1990. Between 1994 and 2001 the increase of GDP per capita was similar in these three countries with more than 3% per year in Spain and Portugal and a little bit less in Greece whereas the EU's average was slightly above 2% per year.

During the 2000-2006 period the amounts transferred to the objective 1 regions represent 0.9% of the Spanish GDP and more than 2.5% of the Greek and Portuguese GDP. The Commission considers that these transfers increase the investments in Spain by at about 3% and by 8-9% in Greece and Portugal, by 7% in the Italian Mezzogiorno and by 4% in the new German Länder. Therefore, there is a direct relationship between the amount of the structural help given to the objective 1 regions and the real growth of the GDP.

The increase of the rate of employment between 1996 and 2002 was particularly significant in Spain and much smaller in Portugal and Greece. However, the rate of employment in these three countries was never higher than the average of the EU.

Table 2. Rate of employment in EU of 15, 1996 and 2002
(% of the population of working age)

	1996	2002
EU of 15	*59.9*	*64.2*
Cohesion countries	51.5	60.2
Greece	54.9	56.9
Spain	47.6	58.4
Ireland	54.9	65.0
Portugal	62.3	68.6
Other Member States	61.7	65.1

Source: Eurostat.

2.2. Persistent Disparities

It's obvious that the so-called cohesion countries profited from the cohesion policy in order to approach, in terms of GDP per capita, the Community average. However, this dynamics did not help equally all the objective 1 regions. An analysis of the regional GDPs shows that even if a decrease between regional disparities is confirmed, it is still much smaller than the reduction in disparities between the Member States. One can even observe a kind of infranational development contradicting the objective of catching up. In addition to that, on the regional level some gaps appeared both within the Member States and in the whole Community. So, just before the enlargement, the disparities between the regions remain very big: the average per capita income of the 10% of the population living in the most prosperous regions is 2.6 times as big as the average income of the 10% of the population living in the poorest regions.

3. The Challenge of the Enlargement

3.1. Disparities of the GDP Per Capita Between Today's and Tomorrow's Member States

Ten new Member States will increase more the EU population (20%) than its GDP (5%). Considering that the income level of the new Member States is particularly low, all the countries satisfy the criteria of eligibility for the cohesion funds and nearly all their territory is eligible for the main objective of the Structural funds created and imagined for the still developing regions.

All the new countries are much less prosperous than the present members of the Union, but in a different way. Only Malta, Cyprus, the Czech Republic and Slovenia have a GDP per capita higher than 60% of the average of the EU of 25 (2001). In Poland, Estonia and

Lithuania, it amounts to 40-44% of the average and in Latvia it reaches 36%. In Bulgaria and Rumania it gets close to 26-28% of the average of the EU of 25. On the other hand, it is very important to emphasize that the GDP per capita in Greece and Portugal is between 73-77% of the average of EU of 25.

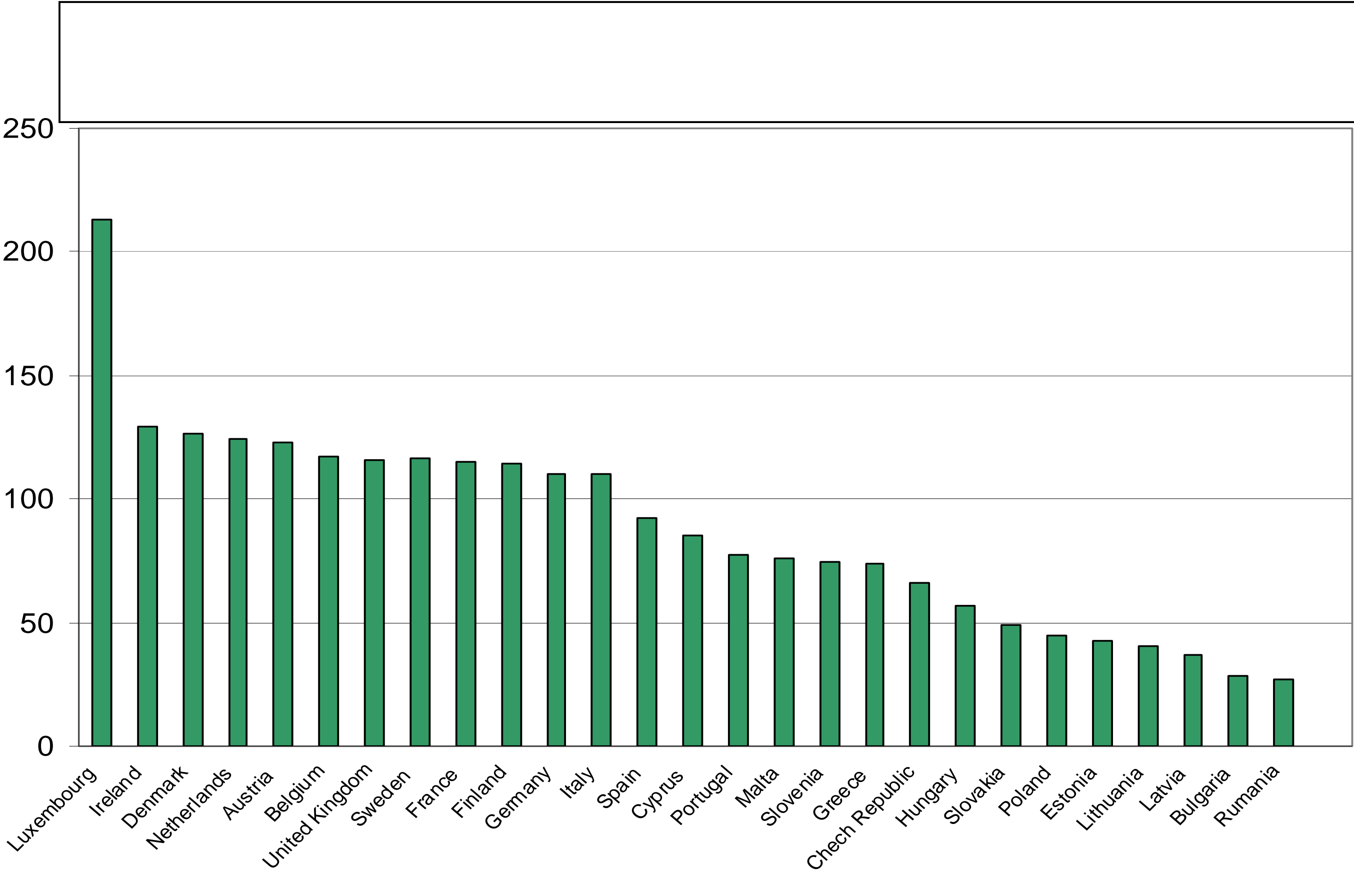
In an enlarged Union the countries could be divided into three groups according to their GDP per capita:

– The first group will be composed of 12 out of 15 present Member States and will have a GDP markedly higher than the European average of the Twenty-Five.

– The second group will be composed of seven countries: three present Member States (Spain, Portugal and Greece) and four new members (Cyprus, the Czech Republic, Slovenia and Malta). Their GDP per capita stands between 66% and 92% of this average.

– The third group will be composed of eight countries (including Romania and Bulgaria) and all of them are either new or future members. The GDP per capita represents less than 57% of the average.

Graph 1. GDP per capita (in PPP), 2001



EU of 25: 100.
Sources : Eurostats.

3.2. Regional Disparities

The EU enlargement will surely have an even stronger impact on regional disparities. Whereas roughly 68 million people lived in the EU of 15 in the regions where the GDP per capita was less than 75% of the Community average, this figure will decrease after the enlargement and this kind of population of the EU of 15 will go down to 47 million in the EU of 25 and further to 24 million in the EU of 27.

In the ten new Member States there are 37 regions eligible for objective 1 of the regional policy with a population of 69 million people (EU of 25). As far as Rumania and Bulgaria are concerned, they will have 13 eligible regions with a population of 30 million people in a Union of 27.

In total, the population living in the regions with a GDP per capita lower than 75% of the average of the Community of 25 will reach 116 million (almost twice as much as in the EU of 15). The part of the population of the Union living in these regions will go from 18 to 25% after the enlargement.

Table 3. Regions and Populations Eligible for the Objective 1 of the Structural Funds

	EU of 15	EU of 25	EU of 27
EU of 15, number of eligible regions	48 regions	30 regions	18 regions
EU of 15, covered population	18%, that is to say 68 million people	12%, that is to say 47 million people	6%, that is to say 24 million people
10 new Member States, number of eligible regions		37 regions	36 regions
10 new Member States, covered population		92%, that is to say 69 million people	90%, that is to say 67 million people
2 new Member States, number of eligible regions			13 regions
2 new Member States, covered population			100%, that is to say 30 million people
Total number of regions	48 regions	67 regions	67 regions
Total of the covered population	18%, that is to say 68 million people	25%, that is to say 116 million people	25%, that is to say 121 million people

Source: Report to the Prime minister (2004).

3.3. Statistic Effects and Phasing Out

The EU enlargement will increase more its population than its GDP. The GDP per capita in the EU of 25 will decrease significantly and will be below the GDP of the EU of 15 by almost 12.5%. Thus, certain regions will have a GDP per capita lower than 75% of the EU of 15 but higher than 75% of the EU of 25 (statistic effects). Therefore, they will lose their eligibility for objective 1 in spite of a situation which, objectively, hasn’t changed. More particularly, it

concerns certain Spanish, Greek and Portuguese regions. On the other hand, it doesn't concern the Länder from the East of Germany because their GDP per capita will remain inferior to 75% of the EU of 25.

Two new mechanisms will be put in place by the next EU enlargement. The first one, called "phasing in" or "natural phasing out", will have to compensate the loss of eligibility linked to the catching up of income level and to the growth of wealth and the second one, called "statistic phasing out", will compensate these statistic effects.

3.4. Challenges to be Taken by the New Member States

The first period of scheduling is relatively short for the new Member States, it only covers the 2004-2006 period. The limit for all the aid allocated in Brussels and in Copenhagen for this period amounts to 40.8 billion Euros in commitment credits in prices of 1999. The credits given to the new Member States represent 15% of the European budget and 0.15% of the wealth of the Fifteen in 2006. From this amount of 40.8 billion Euros, more than a half is planned for structural actions (21.7 billion Euros).

For the period after 2007 the total of the annual aid received by the Member States in terms of structural actions will remain limited at 4% of the national GDP. This rule which was introduced by the Berlin agreement on financial perspectives for 2000-2006 aims at respecting the "capacity of absorption" of public financing in the EU Member States. Its objective is not to put too much pressure on national budgets of new Member States because the public financing should co-finance all the projects. It is also important to avoid any distortions which may be harmful for the normal running of economy.

The main objective for the new Member States will be to reach and maintain a high rate of economic growth in order to improve the standard of living and employment. Improving transport should be a priority in most countries, not only in order to boost the development but also to facilitate trade between regions and countries. New countries should reform their systems of education and training in order to face market demands more easily. A support of the productive investment is equally very important, especially in terms of changes that should intervene in the structure of activities. And, finally, big efforts should be made to reinforce the capacity of administration, to form the administrative staff and to develop effective measures of management and coordination of Community programs linked to the CAP and regional policy.

4. How the Commission Sees the Reform

The instructions how to use the structural funds for the 2000-2006 period were defined by the Commission in 1999: economic growth and employment for a better regional competition and a better-balanced development of the territories. A reform of the cohesion policy for the following scheduling period of 2007-2013 was proposed by the Commission in February 2004. In its third report on the economic and social cohesion, the Commission proposes a new partnership in order to reinforce convergence, competition and collaboration within the EU.

4.1. The Commission's Position

The Commission wants to increase the budget for the cohesion policy by 43% for the 2007-2013 period in comparison with the 2000-2006 one. Its proposal is to allocate an amount which corresponds to 0.41% of the national gross investment of the EU of 27 (0.46% before the transfer of the credits for the rural and fishing development toward "sustainable development and protection of natural resources") to three priorities of the reformed cohesion policy. Thus, this budget will reach 336.3 billion Euros just for operational expenditures and will represent more than 52% for the 12 new members in 2013. Consequently, the Commission's proposal will go up to 370 billion Euros for 2007-2013.

Michel Barnier, who at the time was the European Commissioner in charge of regional policy, acknowledged that disparities inside the Union would keep on growing even after the enlargement and therefore he suggested to reorganize this reformed policy around three objectives: convergence, regional competition and employment, territorial co-operation.

– *A new objective 1 of convergence* (former objective 1 and cohesion funds). It is supposed to help economic growth and job creation both in the Member States and in the poorest regions. It should absorb 78% of the total budget of the cohesion policy, that is to say 262 billion Euros. This objective concerns first of all those regions whose GDP per capita is less than 75% of the Community average (the EU, measured in purchasing power parity) and will principally touch on new Member States. With the "objective 1.a", the Commission proposes also to allocate a temporary help to the regions whose GDP per capita was less than 75% of the average of the Union of 15 and more than 75% of the EU of 25 ("statistic phasing out"). This financing will be almost equal to objective 1 during the first three years and then slightly degressive in the following years. By the end of the period this new instrument which has many things in common with objective 1 will cost 22 billion Euros. The Member States whose

GNP is less than 90% of the Community average (EU of 25, PPP) will be eligible for the cohesion funds which on its turn will finance the programs of transport and environment. In total, new Member States will be given 65% of objective 1 and the old ones only 35%.

– *Objective 2 of regional competition and employment* (former objectives 2 and 3). This objective is composed of a national part called "employment" and a regional one called "competition". The Member States will be in charge of defining eligible regions whereas the whole regions and not just certain predetermined ones should be concerned. It also represents the end of micro-zones which have been common so far. 60 billion Euros, that is to say 18% of the whole budget allocated for the cohesion policy are planned for that objective. The aid goes above all to the old Member States as well as to Cyprus and to the regions of Budapest, Bratislava and Prague. Thus, the Community intervention will be focused on the promotion of innovation and R&D, on more accessible services of the general economic interest, on environment protection and on the prevention of natural risks (for instance, investment into the infrastructure for sustainable development, rehabilitation of the industrial sites previously closed down, promotion of durable public transport in city areas, development of renewable energies). To all these goals we can also add the credits for "natural phasing out" of objective 1 (since the results of objective 1 do not depend on a decrease of the average Community GDP but rather on an increase of the regional GDP).

– *Objective 3 – the one which is planned for the European territorial co-operation.* This objective will be given a budget of 13.5 billion Euros, that is to say 4% of the whole budget for the cohesion policy and will be used to reinforce the instruments of a transnational, cross-border and interregional co-operation. Within the frame of this objective, the Commission suggests the creation of a new legal instrument which would allow both the Member States and the regions to face legal and administrative problems that are traditionally met when managing cross-border projects. This new objective 3 will take the place of the Community initiative called INTERREG.

Commission's proposals follow the objectives stated by the Lisbon Council of Europe in 2000 whose aim was to transform the Union into a dynamic and competitive economic power. They equally follow the objectives of the Goteborg Council in 2001 which emphasize environment protection as well as a creation of a model of sustainable development. According to the Commission, regional competition reinforced by the intervention of structural funds, could be a way to meet these objectives. Since economic growth and cohesion mutually reinforce each other, structural funds will play the essential part and reinforce the economic, research and development competition.

In addition to that, the Commission wants to facilitate the package of measures, as well at the level of scheduling as at the level of control. It proposes to reduce the number of financial instruments from six today to three: ERDF, ESF and cohesion funds. The same program could not be financed by several funds at the same time.

In order to improve the efficiency of cohesion policy, the Commission plans to delegate more responsibility to the partners who are already present in the Member States, in the regions or at the level of local authorities. It also considers reinforcing its partnership with the European Investment Bank and the European Investment Fund. The system of payment (advances and reimbursements), automatic clearing (the rule of "N+2" according to which the annual financial tranche of a program co-financed by the Funds should be spent by the end of the second year after the undertaking) as well as the principle of additionality according to which Community resources should be added to national resources and not replaced by them, will be maintained.

4.2. How the Member States see the Coming Negotiations

Though all the Member States are interested in the cohesion policy, there are also some differences in opinion and certain divides as far as its future is concerned. However, we can divide them into five groups:

– The first group is composed of *the Netherlands, the United Kingdom and Sweden* and is in favor of a renationalization of the cohesion policy (22 other countries prefer to keep the regional theory). The regional policy should correspond to the principle of subsidiarity and be applied according to the national priorities. According to these three countries the regional policy would be much more efficient in reducing the gaps in wealth among the countries of the Union than in reducing the gaps in wealth inside the regions of the same country. Only the Union's poorest countries – and especially the countries of enlargement – could profit from the European subsidies and therefore would be obliged to allocate the resources to the regions which need them most. The Netherlands, the United Kingdom and Sweden wish to reduce their net contributions to the regional policy and consider that it is unfair to be obliged to pay for the countries of the similar level of wealth and which, in addition to that, were unable to solve the problem of their territorial inequalities (Italy for example).

– The second group – *Austria, Denmark and Germany* – wants to keep the cohesion policy concentrated on the actions of cohesion and prefers to maintain objective 1. The criteria for

eligibility for an aid will be regional. The position of this group is shared by *Italy* who wants to keep the funds it has been receiving for the Mezzogiorno.

– The third group is composed of the cohesion countries: *Spain, Portugal and Greece* and who want to keep their returns in the form of cohesion funds or in the form of objective 1. The main demand of these countries is to introduce a generous phasing out in objective 1 for all the regions concerned by the statistic effect. The Spanish position is more complex. If we have a look at the Commission's proposal, for the 2007-2013 period Spain will not receive but 50-60% of the amount it received in the years 2000-2006. This decrease could be explained by a "statistic" consequence of the eligibility for the cohesion funds. In addition to its demand for the introduction of a phasing out for objective 1, Spain's main requirement is to introduce a phasing out for the cohesion funds (which has never been proposed by the Commission). However, it should be underlined that the Commission's proposal would lead to a very big difference in terms of aids between the new Member States and EU of 15 and that it would be much more profitable for the last one. Financially speaking, the aid will remain at 409 Euros per capita in Portugal whereas there won't be but 267 Euros per capita in the ten new Member States.

– The fourth group is composed of *Belgium, France and Finland* which said they were in favor of a future objective 2. They also wish to go on with the cohesion policy in favor of all the European regions and not only in favor of those which are still developing. France is particularly interested in the current objectives 2 and 3 from which it has been profiting most (19% of the whole budget for 2001, including both objective 2 and 3). France's position is that the new objective 2 will not be profitable only for France itself but also for other countries. Therefore, eligibility for objective 1 and eligibility for objective 2 are mutually exclusive. However, several regions won't be eligible for objective 1 anymore, either because of the increase of the level of wealth and income ("natural phasing out") or because of a statistic effect ("statistic phasing out"). Therefore, not being eligible for objective 1 could mean being eligible for objective 2.

– Concerning *new Member States* which will negotiate the future of the cohesion policy on equal terms with the old Member States, they support a generous budgetary position that would concern all the regions of the European Union. They are afraid of a cohesion policy that would concern exclusively still developing countries and regions. Such a policy would be based on a principle of conditionality and that's why they are afraid it could eventually backfire on them. However, their point of view could change according to the balance established by the negotiations on financial prospects. All the Member States including

France are concerned by this remark. Namely, at the forum on cohesion which took place in Brussels on May 10 and 11, 2004 several French ministers confirmed again that the global theory of the Community budget was to be given priority. That's why, first the general framework and then the available means for different policies, especially for the cohesion policy, were clearly defined.

Bibliography

Commission's third report on economic and social cohesion, <www.europa.eu.int/comm/regional_policy/sources/docoffic/official/reports/cohesion3/cohesion3_fr.htm>.

Report to the Prime Minister on "European financial prospects 2007-2013", Marc Laffineur and Serge Vinçon, February 2004, <www.ladocumentationfrançaise.fr/brp/notices/044000098.shtl>.

Informative report No204 by the Senate on behalf of a delegation for the European Union on the prospects of evolution of the cohesion policy after 2006, Yann Gaillard and Simon Stour, February 2004, <www.senat.fr/rap/r03-204/r03-204.html>.

Towards a European Budget Dedicated to Security and Defense

PATRICE CARDOT[1]

This article is an innovation as far as the building of political Europe is concerned, since it formulates an amount of proposals regarding the introduction of elements dedicated to security and defense in the next European financial perspectives (hereafter "FP").

Its recommendations proceed from the analysis and action proposals previously published in the *Défense nationale* review[2], as well as from an examination of the expenditure assigned to the same lines of action by European states. They also take into account the priorities and balances that the EU's institutions and the states intend to set among the political areas that could benefit from a European financial intervention.

This article explains the main action proposals previously mentioned, and then presents the hypotheses that presided over the making of the different financial choices, and the amounts of the categories of expenses foreseen on the seven-year programming period.

1. The Main Action Proposals

The European Commission's proposal for the next financial perspectives of the EU[3] does not mention in the slightest manner a forthcoming opening of the EU's financial programming to the common financing of the expenditure involved by the growing importance of the European Security and Defense Policy (ESDP). However, a certain number of elements emphasize the strategic emergency as well as the political necessity, and the economical, social and financial interest of such an opening, which would undoubtedly strengthen the integrative function of the Union budget.

---

[1] Assistant for European Affairs of the President of the General Studies section at the French "Conseil Général de l'Armement".
[2] In Patrice Cardot, "A step towards the European budget for Security and Defense", *Défense nationale*, 2004, <www.defnat.com>.
[3] COM (2004) final, dated February 10th 2004.

After its launch by the French-Britannic summit of Saint-Malo (1998), and its confirmation by the European Councils of Cologne and Helsinki (1999), the ESDP is currently in a phase of increasing importance. The first military operations led on behalf of the EU took place in 2003 in Macedonia and in the Republic of Congo. But in spite of a genuine awareness of the potentialities allowed by innovating solutions for its financing, the ESDP remains regrettably influenced, culturally and practically, by an alliance dynamics (such as North Atlantic Treaty Organization [NATO]), rather than a political Union dynamics.

In fact, at this point, only the administration costs caused by the working of the institutions, the additional costs, and a few categories of overhead costs induced by the deployment of means during a crisis management operation may benefit from a common financing, in accordance with the orientations adopted by the Council, which were confirmed by the establishment of the ATHENA mechanism, created by the Union to support such expenditure. This, of course, excludes any other "individual cost" of intervention, which remains on the expense of the concerned state ("cost lie where they fall"), in virtue of the European Council decisions approving the financing modalities for such operations[4]. The common financing does not concern the military means and capacities offered voluntarily by the states as they were recorded in the Helsinki Force Catalogue (HFC) either. Last, it does not cover the fulfilling of the lacks of capacities that could appear during the force elaboration process.

The *status quo* tends to be confirmed by Denmark's very singular position towards the ESDP ("opting out"), the existence, inside the EU, of certain states who presents themselves as "neutral" or "non-aligned", and the concerns of the new Member States about preserving their freshly recovered sovereignty.

Is it possible, in such conditions, to consider a commitment of the states in favor of an increment of European expenditure, and the common financing of the European political intervention frame enlargement to new strategic fields?

The answer is positive, considering the amount of advantages and disadvantages brought by such an innovation (*cf.* the previously quoted article).

[4] Cf. annex II of the Presidency on the ESDP, No.10160/2/02 Rev 2 COSDP 188, dated June 22th 2002, that sets in particular the general principles of such a financing and proposes a first list of common costs along with their definitions.

In spite of the various obstacles that still stand against this virtuous process, using Union's own resources to finance the expenditure attributed to security and defense is already possible, since the current situation does not represent a legal emptiness in this matter; moreover, some initiatives have already been taken, destined to permit to the states to support the financial obligations due to the commitments they might have made in common, whether in NATO or in the ESDP. Last, the perspectives appear to be favorable in this area.

Four main ideas seem likely to be applied as soon as the next EU financial multi-annual programming:

– Joint and several financing of all expenditure caused by the working of the European structures and organs operating for the security and defense parts of the Common Foreign and Security Policy (CFSP), including the ESDP;

– Joint and several – and not only common – financing of expenditure in relation with operations implying military or defense elements, that are carried out on behalf of the ESDP, accordingly with the terms of the EU concept relative to this common financing;

– Joint and several co-financing of the investment expenses to be engaged for the Union programs destined to prepare further achievements in the security area, including its defense dimension;

– Joint and several co-financing of the investment appropriations to be engaged, whether in programs conducted in the EU for the acquisition of security and military equipment, or in programs destined to ensure the maintenance in operational condition of the equipment that is part of the ESDP required capacity.

2. Prerequisites

If the competent institutions in fact intended to carry out such a budgetary experiment as soon as the next multi-annual financial programming, they would have to set a certain number of founding principles, mainly from a political and budgetary point of view. Those principles would work as basis for a political Europe, which would be fully willing to act as an autonomous and sovereign political actor, ready to play a global part in the world affairs.

2.1. Political Elements

Among the founding principles of political nature that will have to be set before such a political innovation is launched are undoubtedly the followings:

– Taking into account the rising, in the EU, of a new inter-institutional balance basis as far as security and defense are concerned. Such a balance should take advantage of the major innovations introduced by the subsidiarity protocol, the progresses of the European Parliament powers on the political and budgetary questions, the progressive reconciling of the EU Parliament and the national Parliaments in order to grant the complete coherence of parliamentary positions, whenever those are expressed in the political matters in which the EU and the Member States share competence;

– Taking into account that no interpretation of the treaty should forbid to the EU to benefit from a “useful effect” from one of its dispositions; it should also be proposed that the treaty’s dispositions regarding the appliance of the CFSP – including the ESDP – are interpreted extensively;

– Taking also into account that only the goal and content of a foreseen operation define its juridical basis and its financing source, and not the considerations regarding the nature of the organ in charge of its appliance;

– It should be said that the financial mechanisms ruling over the NATO are not necessarily appropriated to the nature of the EU, which is far more than a “simple” alliance, whatever the efficiency of these mechanisms is, and in spite of the credit they are being given in the military general staffs, due to the persistence of ancient habits in such fields;

– The main principles deriving from the EU concept of common financing should be enlarged; in particular, the joint and several financing of the common costs and overhead costs should be extended to the financing of the Member States military means and capacities;

– A *European framework law of multi-annual programming* on security and defense should be defined and adopted as soon as possible, so that it can produce its first effects during the 2007-2013 period (for instance, France could build its next military programming law 2009-2014 in accordance with the orientations of this European framework law);

– A budgetary building should be included in the financial perspectives: this building should respect certain irreducible political demands about the FP's global headings, the Union main political priorities, and/or the main balances between/inside the different rubrics; it should allow the Union as well as the Member States to take the better advantage of a proper application of the additionality principle, whenever it makes sense; it would thus bring the embodiment, through their dynamic interpretation, of the commitments made in common on behalf of the ESDP, under the form of an effective and long-lasting budgetary solidarity;

– Last, the better advantage should be taken of a new inter-institutional agreement on budgetary discipline, in which appropriate dispositions for the operational and efficient bringing in use of the innovations defined for the political and budgetary construction of the FP's "Security and Defense" chapter should be inscribed.

2.2. Budgetary Elements

Before the opening of a credit line specifically devoted to ESDP expenditure in the 2007-2013 FP is launched, a certain number of budgetary principles have to be set, among which the followings:

– The budgetary space should be divided into various chapters, in order to respect the general principle that edicts the rule according to which the aim and content of a given operation set its juridical basis and its financing source, and not the organ that carries it out;

– All operational expenditure related to activities that have strong implications in the security and defense areas and that juridically depend on the EU budget, should be inscribed in a particular rubric dedicated to the Union's external action;

– All expenditure related to activities that have strong implications in the civilian field of action should be inscribed in the general rubrics, particularly when they concern investment expenditure in favor of the research on security;

– As far as the unprogrammed/unforeseeable expenditure is concerned, the use of the margin under ceiling existing in the corresponding chapter or the reserve for emergency action should be preferred to the use of an hypothetical action mechanism on budgetary stability;

– Last, the better advantage should be taken of the new dispositions in the financial regulation applying to the Union general budget, as well as those recently introduced in certain of its corollaries, such as the “Agencies” regulation.

3. Commented Calculating

For each one of the four main paths of effort foreseen, the retained hypothesis and the position of the corresponding credit lines in the FP’s budgetary structure are presented hereafter.

3.1. Expenditure Caused by the Working of the Structures Related to the ESDP

This first category of expenditure covers all the administrative expenses caused by the working cost of the Union structures that are related or depend on the Council, and are permanently in charge of the supervision and animation of the EU action in the ESDP field.

It contains schematically three main lines of credit:

– *A1*: Administrative expenditure caused by the working of the Council’s General Secretariat or the organs and committees that depend on it and also treats (or will treat) such questions (Political and Security Committee [PSC or COPS as it is known by its French acronym], Military committee of the EU, Military staff of the EU, Joint situation centre, operational planning centre, etc.);

– *A2*: Administrative expenditure caused by the working of the EU’s two organs (EU Satellite centre, Institute for Security Studies) that were transferred to the EU, without any modification of the financing of their budget, although such a change was allowed by the terms of the Treaty;

– *A3*: Administrative expenditure caused by the administrative working of the new-born European Defense Agency (EDA), whose infrastructures and manpower will generate important costs as soon as 2007.

The *A1 line* already has its own place in the budget, in the section II “Council” of the EC general budget (*cf.* the section’s titles related to the CFSP and the ESDP). The existing customs should be kept up with, and the level of expenditure adapted to the foreseen needs.

The *A2 line* aims at the opening of the ATHENA financing mechanism to a common financing by the EU of the working budget of permanent organs, reporting to the Council, and playing a specific part in the CFSP and the ESDP. Those organ's respective budgets should be financed on the basis of the EU general budget's section II "Council", in accordance with the dispositions of the Treaty on the EU related to the administrative expenditure inherent in the CFSP.

The *A3 line* depends *de facto* on the A1 category. However, insofar as it seems necessary to confer a political visibility to the public investments that the Union intends to consecrate to financing the working of an agency whose mission is genuinely strategic, it is recommended to create a specific line to that purpose. In that case too, the corresponding credits should be inscribed in the EU budget's section II "Council"[5].

3.2. Expenditure Caused by Military Operations Led in the ESDP Framework

This second category of expenditure covers in fact two different types of expenditure (*i.e.* administrative expenditure, operational expenditure charged to the EU budget) caused by a joint and several financing of the costs and overhead costs that depend on a common financing *via* the use of the ATHENA mechanism that is currently being created, because of specific dispositions of the Council, and in accordance with the appropriated dispositions of the Treaty.

The recurrent difficulties that Member States encounter when they have to pay for such expenditure on their own budget[6] plead in favor of such an innovation. It could be embodied by a contribution to the European budget attached to the ATHENA mechanism, under the form of an annual global subvention.

It contains schematically three main lines of credit:

– *B1*: administrative expenditure caused by the overhead costs for the Military Staffs, as well as those caused by the supporting of the force in general;

[5] The annex's counting proceeds from a non-linear extrapolation of the one that was proposed by the staff in charge of the Agency launching for the same category of expenditure in 2005 (starting year). Moreover, it takes into account the necessity to improve the financing of this growing agency.
[6] As an example, such is the case in France, where the "OPEX overhead costs" reach 600 million Euros every year.

– *B2*: operational expenditure caused by investment additional costs for the military staffs, as well as those caused by the support of the force in general, *whose positive impact on the EU exceeds the length of the operation*;

– *B3*: administrative and operational expenditure caused by the intervention of military means in the process of rescue operations, depending on the civilian protection in the CFPS crisis management frame.

The *B1 line* implies a certain number of prerequisites:

– The Council should accept to note down the new potentialities offered by the Court of Justice of the European Communities (or European Court of Justice, ECJ) jurisprudence, so that such activities can be in fact charged on the European budget;

– An evolution of the rules and principles that seem likely to preside over the working of the brand-new ATHENA mechanism that the EU dedicates to the common financing of certain categories of costs and overhead costs, whether for the military staffs, or for the force in general, caused by military operations led on behalf of the ESDP;

– An explicit and formal qualification of *administrative expenditure* granted to the expenditure virtually related to this specific line of credit in the financial agreement that will be established for any military operation in the future, accordingly with the Council's decisions;

– And the adoption of a Council decision (joint action) confirming the inscription within the EU general budget of lines of credit likely to cover the expenditure related to such activities. The decision should specify the respective responsibilities of the Commission, the European Parliament, the Council, the European Defense Agency and the Member States in the building, the adoption, the enforcement and the evaluation of such a program, as in the setting of the rules and principles enforceable to the common financing of such expenditure.

These credits will be inscribed in the title III (related to the ESDP) of the section II "Council"[7].

The *B2 line* implies both the fulfilling of the preceding demands (except for the third one) and:

[7] The proposed counting roughly corresponds to the consolidated amount of the corresponding expenditure committed every year by France and Great-Britain when those states act as a frame-Nation.

– The existence of adequate dispositions in the inter-institutional agreement on budgetary discipline and/or of a “gentlemen’s agreement” between the Council and the Parliament, so that the first one can *de facto* benefit from a capability to decide with full responsibility of the affectation of the corresponding credits;

– An explicit and formal qualification of the expenditure susceptible to form part of this line of credit as expenditure of operational nature that thus should be charged on the European budget, in the financial agreement that will be established for every military operation, in conformity with the Council decisions for such matters.

These credits will have to be inscribed within the section title related to the “Peace and Security” instrument of the section III “Commission”, whose creation is foreseen by the Commission. Besides, it is proposed to inscribe a specific line allowing to cover the unexpected expenditure related to this category in the title dedicated to the “reserve for emergency action”[8].

The *B3 line* aims to inscribe the costs and overhead costs attributable to the military staffs or the military forces involved in the course of rescue operations related to the civilian protection in the crisis management for the ESDP on behalf of the EU, in the section III “Commission” line of credit dedicated to cover administrative and operational expenditure caused by such rescue operations, and charged on the Union budget.

Those credits will be inscribed in the section II title “Council” related to the CFSP for the common administrative costs and overhead costs, and in the section III title “Commission” related to the “Peace and Security” instrument for the operational costs and overhead costs charged on the Union budget. Moreover, it is proposed to inscribe a specific line allowing the coverage of unexpected expenditure depending on that category in the title dedicated to the “emergency action reserve”.

3.3. Expenditure Caused by Public Common Investments in Favor of Research and Technology

This third category of expenditure only covers operational expenditure charged on the EU budget. It concerns the financing or the co-financing, by the Union budget, of a European program devoted to research for security (*i.e.* ERSP), that should find its place in the

forthcoming frame-programs of research, technological development and exhibition of the EU (ERDP), in accordance with the appropriated dispositions of the Treaty. It is limited to the "Security and Defense" chapter of this program, whose global management (planning, programming, enforcement…) will be depending *ipso jure* on the European Defense Agency as a complement and support of the corresponding national programs.

It is proposed that the credits required for the covering of the C1 category expenditure should be inscribed in the title III "Commission" section, related to the "Peace and Security" instrument. The C1 category covers all operational expenditure related to the joint and several co-financing of research activities, as well as exhibition activities determined by the technical specifications of the technical part of the capacitative process related to the ESDP (ECAP)[9].

This implies, in the case where the Nice system would remain in vigor:

– That the Council has accepted to note down the new potentialities offered by the European Communities Court of Justice jurisprudence, so that the research and exhibition activities having military implications as far as the defense is concerned can be effectively charged on the Union budget;

– The existence of proper dispositions in the inter-institutional agreement on budgetary discipline and/or of a "gentlemen's agreement" between the Parliament and the Council, so that the last one can de facto dispose of a full-responsibility enactment capacity, regarding the use of the corresponding credits, although the "non compulsory" nature of those expenses depends *de jure* on the Parliament powers;

– The adoption of a Council decision (joint action) confirming the inscription of credits liable to cover the expenditure related to those two activities, first inside the title related to the ESDP, second inside the title related to the "peace and security" instrument. This decision should also specify the respective responsibilities of the Commission, the Council, the European Parliament, the European Defense Agency and the Member States in the building,

---

[8] The proposed counting also corresponds here to the consolidated amount of expenditure made every year by France and Great-Britain when those states act as a frame-Nation.

[9] It is possible to use another budgetary building, that would consist in joining together all the credits destined to cover both categories of expenditure caused by the ERSP's civilian and military chapters; this will be made possible by the adoption, then the ratification of the Treaty establishing a Constitution for Europe.

the adoption, the enforcement and the evaluation of such a program, as in the setting of the rules and principles that can be applied to the co-financing of such expenditure[10].

3.4. Expenditure Caused by Common Public Investments in Favor of Security and Military Equipment Related to the EPAC

This fourth category of expenditure only covers operational expenditure charged on the Union budget. It covers the financing or the co-financing (as a backing to national financing) of operational expenditure *charged on the Union budget*, and for certain categories of common activities related to two fields. First come the *phases of feasibility and definition* of European common acquisition programs that should be enforced during the next steps of the capacitative process related to the ESDP (in the framework of the capacities development mechanism set by the Council); in second comes the *maintenance in operational condition* (MOC) of the equipment involved in the military capacity required for the effective enforcement of the ESDP. This should be made coherently, as a complement and a backing of the similar national capacities.
It contains two main lines of credits:

– *D1*: operational expenditure due to common activities related to the phases of feasibility and definition of the European common acquisition programs;

– *D2*: operational expenses caused by certain costs and overhead costs liable to the activities of maintenance in operational condition (MOC) of the military capacities used by the ESDP.

The *D1 and D2 lines* imply the fulfilling of the *line B1* prerequisites, and also:

– The building-up of a proper mechanism (based on the revised ATHENA model) permitting to the Union the joint and several co-financing of certain categories of costs and overhead costs otherwise charged on the Union or the Member States budgets. This mechanism would concern the *conception* costs as well as the *maintenance in operational conditions* costs of

[10] It was decided to charge on this C1 category an annual amount representing about 15% of the credits that are very likely to be consented at the next FPRD (framework program for research and development), this cipher representing roughly more than 50% of the consolidated amount consented every year to the “non-nuclear R&T” by the Ministries of Defense of the states that are parts to the Letter of intent (France, Germany, United Kingdom, Sweden, Italy and Spain). Such a counting proceeds from a deep analysis of the various national agendas for military programming.

the equipment required by the *force* systems intervening in the capacitative system necessary for the ESDP;

– There should also be an explicit and formal qualification of the expenditure eligible to these specific lines of credit as *expenditure of operational nature, whose positive impact on the European Union exceeds the length of an operation, and that thus should be charged on the Union budget*, accordingly with the Council decisions on these matters.

About the *D1 line*, the equipment programs, for security and defense, comprise four distinct phases: a phase of feasibility studies, a phase of conception studies, a phase of development and a phase of production. The so-called conception step includes the two first phases, and the so-called realization step the remaining. It seemed reasonable to restrict to the sole expenditure imputable to the *equipment common conception* the possibility of having recourse to the Union budget to co-finance expenditure required by both the Union political credibility in the ESDP field, and the ESDP operational efficiency.

Further analysis of the real cost of the activities typically related to the equipment conception programs to which France and other Member States of the EU are taking part (1.000 million Euros for the military programming period), of the perspectives offered by the projects established in the EU around its capacitative gaps[11], as well as the considering of the existence, in the NATO structure, of a similar capacitative process (which implies to choose between the different ways to be followed and financed for the forthcoming equipment production) allow to set the amount of this line up to 200 million Euros in commitment appropriations (CA) and 170 million Euros in payment appropriations (PA) every year.

About the *D2 line*, the maintenance in operational condition of the equipment involved in the force systems that form the Union capacities, without whom the ESDP would not be operational, has become a major concern of the political and military authorities inside the Union. Thus one of this project's main concerns was to open in the European budgetary framework a space devoted to the covering of certain categories of costs and overhead costs caused by such activities, which are essentially strategic. This option's advantage as well as its inevitable nature, is strengthened by the current financial situation of the main contributing States, which *de facto* forbids them to finance by their sole national financial means the totality of the expenditure assigned to them as far as such issues are concerned.

The Council not having the capacity to dispose of credits liable to cover any operational expenditure, the lines of credit destined to cover such expenditure should appear in the Title of section III "Commission" related to the "Peace and Security" instrument (current chapter 19).

4. Conclusion

The proposed counting sets up globally to 22 billion Euros in CE and 20 million Euros in CP on the 2007-2013 period (roughly 3 billion Euros each year).

If those amount may seem somehow weak in relation with the real needs (they represent 0,03% of the Union GNR[12], and less than 50% of the unused payment credits that are returned to the States by the Commission every year[13]), they nevertheless represent the tangible proof of the launching of an integrative process, which is necessary to the deepening of the effort that is soon to be devoted to the EU Security and Defense by the Union and the States, accordingly with their common responsibilities towards the progressive establishment of a common Defense policy.

It should be noticed that the whole European Union, although its GNR is similar to the US, and its population superior of 50%, does not spend as half as the US for military expenditure. For instance, in military research, the US spends more than 50 billion Euros a year, when all the European states spend 10 billion Euros. If the EU spent 15 billion Euros more per year in order to develop its military research and development effort, it would still represent only half of the American effort.

The proposed scenario is, and it is not the least of its assets, entirely compatible with the two other minimalists scenarios ("Conservative" and "Competitiveness-Solidarity") that were examined in the fourth part of this study, even though it is influenced in its logic by the dynamics inherent in the third scenario "European public goods", which represents *de facto* its maximalist version by proposing to raise the expenditure level from 0,03% of the GNR up to 0,12% (or an annual amount of 15 billion Euros). That would naturally demand the adoption of a European military programming law, although this study's counting does not make it strictly necessary.

---

[11] The current European Capability Action Plan (ECAP) shows interest for only 24 of the 42 lacunas identified by the EU in the military sector.
[12] Consolidated Gross National Revenue.

This scenario is institutionally coherent with the concept of "Federation of Nation-States", in which the Union action strengthens the States action whenever they share a similar competence, and whenever the Union acts in the framework of a supporting, complementary or coordinating action competence. Its effective concretizing would have even more interest it was combined with a reasoned practice of the additionality principle.

Such a "European budget for Security and Defense", that could perhaps be part of a budgetary correction aim, must above all be a financial action mean for the Union, allowing it to:

– Launch a virtuous process aiming to comply with proper effectiveness and efficiency to the common ambitions of political, strategic and operational autonomy in the common security and foreign policy field;

– Comply far better with the strong demands of the Pacts to which the States have subscribed, as well as the competitiveness commitments made at the Lisbon European Council;

– Give birth to a new dynamics on the employment market, in a high technology and/or high-profit sector.

The appearance of new expenditure charged on the Union budget, by offering structural financial solutions (hence "sustainable" solutions), would permit to:

– The States to make in a reasonable period of time consequent savings, in order to loosen the restraints that still forbid them to fulfill the political commitments made for the ESDP at the level to which they have voluntarily set them;

– Grant the coherence and complementarity of national and supra-national programming, without hence affecting, neither the States operational performance, nor their free will regarding the use of their capacities, including those under NATO's care.

May the financial and political solidarity that has developed for so many years in areas as strategic as agriculture, research or the various cohesion policies be carried on in a new concrete demonstration of the expressed will of the 25 members of the Union to seal their common political destiny by a global world-action capacity.

---

[13] 15 billion Euros in 2001, 7.4 billion Euros in 2002, 5.4 billion Euros in 2003.

Part Three

European Budget and Political Deepening of Europe

Fiscal Federalism in Euroland

STEFAN COLLIGNON[1]

By adopting the Euro as its single currency, the European Union (EU) has made significant progress in the efficient management of macroeconomic policy. The single market is less vulnerable to financial, economic and political shocks and even non-Euro countries in the Union profit from this fact. However, it has also become apparent that the mix of monetary and fiscal policies has not always been optimal. Domestic demand in Euroland has mostly been feeble, especially when compared to the United Kingdom (UK) and the United States (US), and fiscal policy has been too lax during the boom year 2000 (European Commission 2003). This policy weakness has institutional foundations, as the difficulties of implementing the Stability and Growth Pact reveal. I will argue that an optimal policy mix in Euroland requires an integrated fiscal policy framework that also takes into account the budget of the EU.

1. The EU's Budgetary Constitution

European Monetary Union (EMU) has created a unique institutional arrangement for the conduct of European macroeconomic policy: monetary policy is centralized under the authority of the European Central Bank (ECB) and conducted in a unified and coherent manner. But fiscal policy remains fragmented, with national governments keeping their budgetary authority, and is only loosely constrained by the Excessive Deficit Procedure (EDP) and the related application directives, the Stability and Growth Pact (SGP).

This set-up is somewhat surprising, given that the theory of Fiscal Federalism since Musgrave (1959) has emphasized the welfare gains from centralizing the public finance functions of stabilization and redistribution and decentralizing the allocation function[2]. Earlier EU-documents, like the MacDougall report (1979) and the Delors report (1989) gave a prominent role to fiscal policy: "Both for the purpose of internal macroeconomic objectives and in order to be able to participate in the process of international policy co-ordination, the

[1] Stefan Collignon is a Professor of European Political Economy at the London School of Economics.
[2] In the paper contained in the Delors Report (1989), A. Lamfalussy explicitly referred to Musgrave.

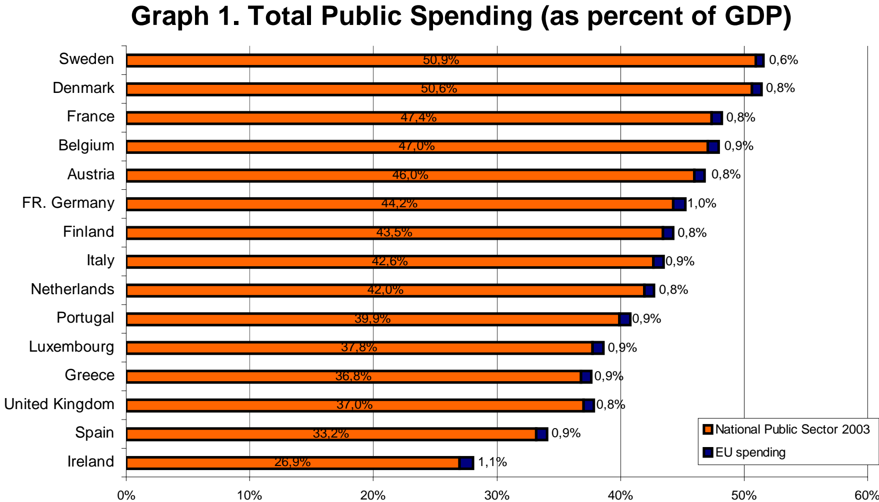
Community will require a framework for determining a coherent mix of monetary and fiscal policies" (Delors Report 1989, p.94). By the time the Maastricht Treaty was negotiated, governments were only willing to give up monetary policy, but not budgetary sovereignty. Stabilization policy had been reduced to maintaining price stability alone and fiscal policy at the European level was limited to prevent the "undue appropriation of EMU savings by one country" (Delors Report 1989, p.95) and the crowding out of private savings through excessive deficits. Also at the theoretical level, the Ricardian Equivalence hypothesis (Barro 1974) had undermined the Keynesian assumption that government net expenditure could compensate shortfalls in private sector demand. Budget policies were now considered ineffective with respect to the real world, but they could cause inflation in the long run. Fiscal discipline was seen as necessary to ensure price stability, but not institutions that actively pursue macroeconomic stability. Yet, if consumers do not internalize the future tax implication of current deficits ("future generations will pay for them"), Ricardian equivalence fails. Consequently in recent years, it has been acknowledged again that fiscal policy can play a smoothing effect on the business cycle by the operation of automatic stabilizers (changes in government revenue and expenditure that arise automatically from fluctuations in economic activity). The new orthodoxy also emphasizes the usefulness of discretionary fiscal policies, although not for demand management, but for supply-side effects, such as improving the potential growth rate, covering pension liabilities, creating labor market flexibility, etc. (ECB 2004). Automatic stabilizers introduce some flexibility into rule-based policies and are therefore a matter of the efficiency of macroeconomic policy, while discretionary policies reflect more fundamental choices of collective policy preferences.

One reason for the EU's institutional arrangement was the recognition by more initially audacious government delegations (especially by France) during the Maastricht negotiation that the loss of national sovereignty on the budget side could lead to a larger EU budget and would not be politically acceptable (Bini-Smaghi, Padoa-Scioppa and Papadia 1994). For example, central government expenditure varies in Australia, USA, Switzerland and Germany between 8 and 14% of GDP, and if social security is included between 18 and 31.2%, while state and local government only spend between 10 and 14% (Ardy 2004). Such proportions are unacceptable for the European Union, and this could pose a problem for the optimal policy mix in Euroland.

The dilemma is that an efficient European budget needs to be small from the point of view of allocative efficiency, but large for stabilization purposes. The efficient allocation of resources requires that the optimal level of public goods (*i.e.* that for which the sum of resident's marginal benefits equals marginal cost) reflects the differences in local preferences and

costs; because preference heterogeneity is assumed to increase with the number of citizens, decentralization is supposed to increase welfare and a big EU budget is undesirable[3]. Yet, if government expenditure is to make a difference in terms of smoothing aggregate demand and income, it must be substantial. This condition is generally fulfilled for national budget policies, but not for the EU budget. Total government expenditure in the USA was 31.9% in 2003, 33.9% in Japan and 44.5% for Euroland, while the total EU budget represents only 1% of GDP. As Lamfalussy put it in the Delors report (1989, p.95): “The size of the Community budget would clearly be too small to provide for an adequate *marge de manoeuvre* for an effective macro-fiscal policy. As a result, in an EMU an appropriate aggregate fiscal policy could not be determined without impinging on the autonomy of national budgetary positions”. Given that most of public spending in the EU is undertaken by Member State governments (see Graph 1), the stabilization function in Euroland must work through national budgets. The aggregate fiscal policy stance in Euroland, which matters for monetary policy, is then simply the book-keeping result of adding up the different national budget positions.

Graph 1. Total Public Spending (as percent of GDP)



According to the orthodox interpretation, this arrangement does not prevent an efficient policy mix (Artis and Buti 2000). If Member States keep their cyclically adjusted budgets in balance, as postulated by the Stability and Growth Pact, the swing of automatic stabilizers

[3] As Oates (2004, p.26-27) points out, “decentralized levels of government focus their efforts on providing public goo whose consumption is limited primarily to their own constituencies. In this way, they can adopt outputs of such servic to the particular tastes, costs, and other circumstances that characterize their own jurisdictions.” Thus, in th decentralizing theory of fiscal federalism, which Europeans call subsidiarity, there is no place for spillover effects public goods into other constituencies. In Collignon (2003) I have argued that this model is not suitable for policy analys in the European Union, where spillover effects are widespread. Many collective goods are consumed by all Europe citizens, although they do not have the institutions to match policy output with the democratic policy input.

provides for the efficient counter-cyclical stabilization of demand shocks. All one needs to do is to provide safeguards against opportunistic behavior by individual Member States.

However, this model has come under criticism from two sides. Some consider it as too rigid with respect to the optimal response to shocks, that is they doubt the system's efficiency for macroeconomic stabilization; others question its optimality with respect to satisfying collective preferences.

2. The Macroeconomic Stabilization Function

Fiscal federalism refers to the development of a centralized budgetary system[4] comprising all members of a federation or federal state and how to assign different functions of public finance to different jurisdictions (Whyman and Bainbridge 2004). The classical theory of fiscal federalism has established three major arguments why a monetary union needs to have a centralized budget policy: stabilizing symmetric and asymmetric shocks and income redistribution.

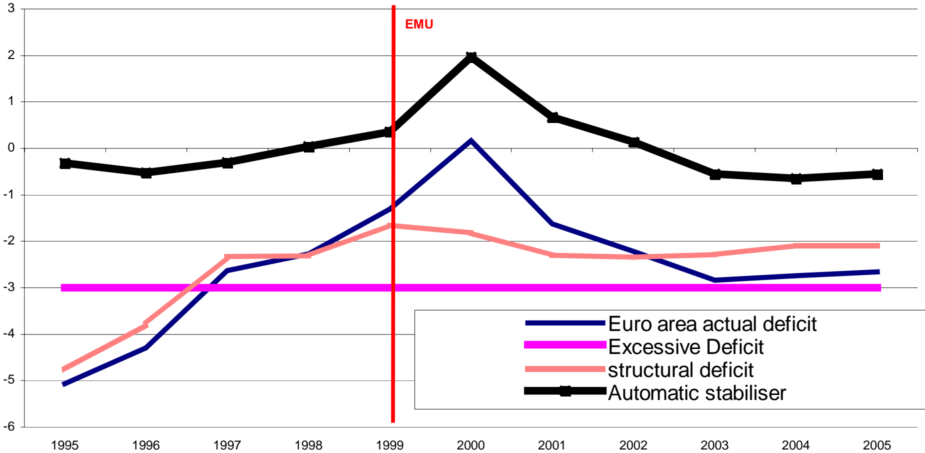
2.1. The Stabilization of Euroland

First, there is the argument of *vertical flexibility* in budget policy. Vertical flexibility is about the appropriate response of an economy to a symmetric shock that hits all regions of the federation in a similar fashion. In principle, monetary policy could respond to such a shock by lowering interest rates and thereby stimulating demand. Similarly, a supply shock, such as an oil price increase, would require a unified response in order to avoid beggar-your-neighborhood behavior and the distortion of relative prices. It is usually argued that a centralized budget is better able to internalize externalities associated with both taxation and expenditure. Regional governments may not undertake an optimal level of counter-cyclical stabilization due to the existence of regional spillovers, whereby non-residents derive some benefits from the policy whilst residents must bear the full cost through higher debt or taxation. In order to avoid this prisoner's dilemma, co-ordination of stabilization policies amongst all members of the monetary union would be required unless a sufficiently large centralized government under federal authority is available. Hence, the European approach to co-ordinate fiscal policies through the Stability and Growth Pact. The Pact stipulates that each Member State should keep its budget "in balance or surplus over the medium term".

[4] This is the half-empty bottle. Of course the same statement can be made in terms of decentralizing competencies.

This must mean that governments keep their cyclically adjusted budgets in balance, so that the automatic stabilizers can smoothen the business cycle.

Graph 2. Euroland Aggregate Fiscal Stance

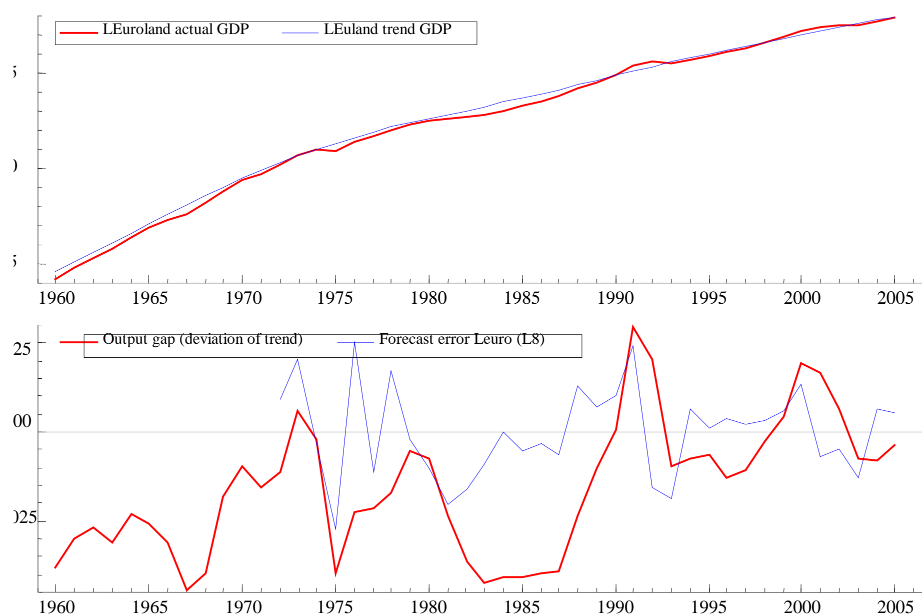


The reality has not exactly followed this model. As Graph 2 shows, the structural deficit of the Euro area has improved in the run-up to EMU, but has remained stable at a level close to 2% since then. The automatic stabilizers did operate in the 2000-boom, but the subsequent deterioration of the cyclically adjusted deficit, due to tax cuts in several Member States, indicates moderate pro-cyclical behavior in the EU's fiscal behavior. In 2003, the aggregate Euroland fiscal position came close to the 3% line, while several individual Member States surpassed it. This is worrisome, for if Euroland were hit by a severe shock (say a dramatic increase in oil prices), the Stability and Growth Pact would restrain the automatic stabilizers and fiscal policy would become pro-cyclically restrictive.

Furthermore, economic shocks have recently been less strong than in previous periods. As Graph 3 shows, the output gap, as measured by the European Commission[5], has been mainly negative before EMU started. However, given the methodological difficulties in measuring output gaps, I have calculated economic shocks as the forecast error of an AR (8) process for the log of annual Euroland GDP. The volatility of economic shocks has clearly fallen since the mid-1990. This may be a consequence of monetary integration, or of a favorable environment, but there is no guarantee that it will stay that way. If volatility increases again, more vertical flexibility would be needed.

[5] Calculated as the deviation from trend output based on a production function. Data source: European Commissio
AMECO.

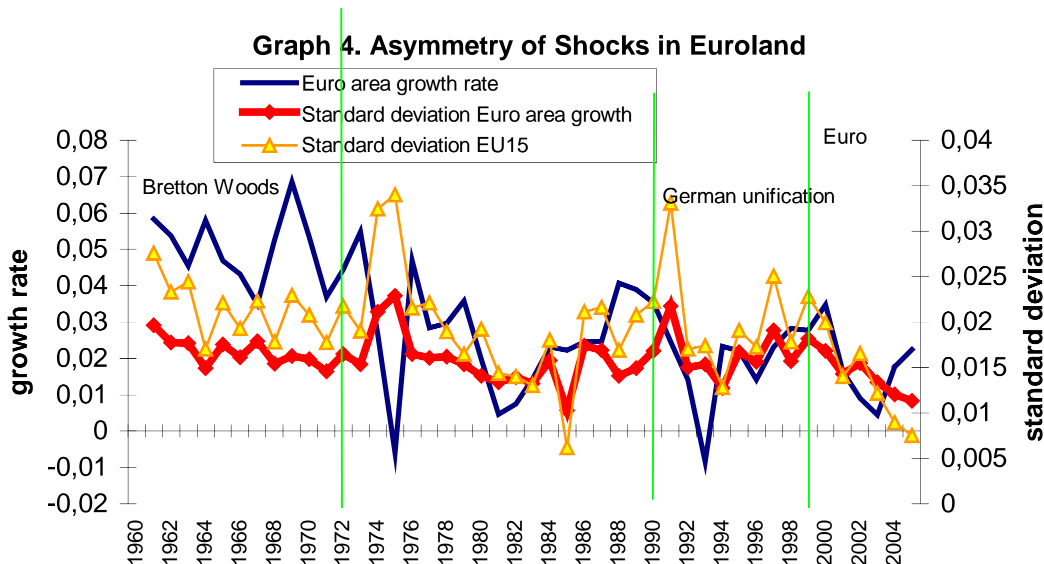
Graph 3. Euroland Output Gaps and Economic Shocks



2.2. Asymmetric Shocks

Second, *horizontal flexibility* and budgetary policy is required when a federation is hit by asymmetric shocks. In this case monetary policy is not available to stimulate local demand, given its unified tools. Regional budgets could provide additional demand and discriminatory fiscal policies could provide distorting supply side effects. Hence, some form of horizontal policy co-ordination is desirable.

The salience of horizontal flexibility depends on the likelihood and the extent of regional asymmetric shocks. The discussion of such shocks has been the delight of economists in the context of Optimal Currency Area theory. But since the start of EMU many economists have learned to accept that the occurrence of asymmetric shocks may be related to the degree of economic and monetary integration (Ackrill 2004, Collignon 2001). Graph 4 indicates that the movements of national GDP growth rates have become more uniform since monetary union started: the standard deviation of annual national growth rates within the EU and the Euro area have been falling. This is all the more interesting, as in previous year a major growth reduction was usually associated with an increase in growth volatility across the area.



Fatás (1998) has distinguished between inter-temporal and interregional transfers, by which a federal fiscal system can compensate asymmetric macroeconomic shocks. Inter-temporal transfers result from government borrowing to stabilize consumers' income in case of an adverse regional shock. While this argument follows the traditional Keynesian stabilization theory, it implies significant externalities and requires different policy solutions in a monetary union. For if the central bank keeps money tight to ensure the economy's hard budget constraint, the extra borrowing of one region would push interest rates up for the whole economy[6]. One reason for the SGP was the intention to prevent individual Member States from free-riding at the expense and detriment of others but this disciplining device comes at the cost of less than optimal stabilization in a country hit by an asymmetric shock. This negative consequence would not emerge if asymmetric shocks were normally distributed. Additional borrowing by one region would then be funded by an unexpected surplus in another region. However, given the very unequal distribution in Member State size, it is unlikely that asymmetric shocks in Euroland have a zero mean. Therefore, inter-temporal transfers interact with aggregate macroeconomic stability and they cannot substitute for interregional transfers.

Some federal systems overcome these difficulties by interregional transfers, which provide insurance against asymmetric shocks by pooling the risks of national income fluctuations at a higher level of aggregation (Schelkle 2002). An inter-regional public insurance scheme redistributes income from favorably shocked to adversely shocked regions, while maintaining

[6] This is an argument about the short-term interest rate in the money market, which is controlled by monetary authoritie
If the long-term interest rate in the capital market were fixed by the international supply and demand for capital, the yie
curve would be negatively affected by regional borrowing.

the overall stability of the aggregate fiscal policy stance required for maintaining price stability[7]. In mature federal states, like the US in the 20th century or Germany today, these horizontal transfers are affected through the federal budget. In the EU this is more complicated. Regional stabilization does not work through an insurance scheme, but essentially through inter-temporal transfers when national budget deficits respond to asymmetric shocks. Interregional transfers do not reflect economic shocks but more fundamental preferences for income redistribution.

3. The Redistribution Function

The redistribution function of the EU budget relates to our third argument in favor of centralizing budget policy in federations. In order to provide continued political support for the Union, solidaristic transfer schemes may be required to help economically weaker regions. These transfers can either be financed through intergovernmental grants or through progressive taxation as in many nation-states. In the EU intergovernmental grants are not financed by a transfer from a federal budget to lower level jurisdictions, but by transfers from national budgets to the EU budget. Thus, the budget of the EU is a redistribution budget. 80% of expenditure is concentrated on the common agriculture policy and structural funds. The former aims at stabilizing income of a specific group of the population; the latter provides matching grants to accelerate regional development. Given that the EU budget is not allowed to borrow in capital markets, all resources are effectively transfers from national treasuries. National governments contribute to the EU budget roughly by size of their country's GDP and they receive funds back from the EU in accordance with the criteria and tasks established for dispersion. Out of 15 EU countries 4 countries have been net-transfer receivers, 10 are net contributors, and in Finland inflows and outflows were balanced. European net-contributions must therefore be seen as one expenditure item amongst many others in national European budgets. Given that the overall fiscal policy framework requires national government budgets to be balanced over the business cycle and to avoid excessive deficits irrespective of the nature of shocks the amount of net-contributions distorts fiscal discipline. This explains partly why discussions of the net-contribution to the European budget are so highly charged by EU Member States.

The EU budget system, linked to the fiscal discipline devices of the SGP, creates an awkward dilemma: the more generous a Member State behaves in transferring resources to

[7] The welfare gain from such insurance device declines, of course, as the likelihood of idiosyncratic shocks diminishe

poorer countries, the higher the likelihood that it will be punished under the Excessive Deficit Procedure, if it is hit by a shock. Each Member State therefore has an incentive to reduce its contribution to the EU budget in order to comply with the SGP. This arrangement increases the risk of European disintegration, particularly at a moment when the accession of 10 new low income countries creates additional claims for resource transfers.

Table 1 gives an idea of the magnitudes in 2002. Net budget transfers into Greece and Portugal exceeded 2% of GDP, in Spain and Ireland they were close to 1.25%. However, the effective tax burden on citizens in the Netherlands is nearly 0.5% of GDP and 0.25% in Sweden, Germany and Italy. Only Finland is in balance. In 6 out of 14 countries (data for Luxemburg were not available) the net contribution to the EU budget is higher than the magnitude of the automatic stabilizers in 2002. As a consequence of the net transfers, Portugal remained below the 3% deficit level of the EDP, and France was pushed beyond the limit. If the Netherlands would wish to balance their structural deficit, as required under the SGP, their consolidation efforts have to be 24% higher than if their net contribution were balanced. For Italy the extra effort is near 10%, for German 7 and France 4%.

Table 1. European net contributions and budget deficits 2002
(in % of GDP)

	Net contribution (NC)	Cycle deficit	Structural deficit (SD)	SD-NC	Actual deficit (AD)	AD-NC
Portugal	2.08	0.02	-2.72	-4.81	-2.71	-4.79
Germany	-0.24	-0.15	-3.37	-3.13	-3.52	-3.28
France	-0.14	0.56	-3.66	-3.52	-3.10	-2.96
Greece	2.40	1.31	-1.46	-3.86	-0.16	-2.55
Italy	-0.23	-0.01	-2.30	-2.07	-2.31	-2.08
Austria	-0.10	-1.43	-0.15	-0.04	-1.58	-1.47
Belgium	-0.10	-1.54	0.02	0.12	-1.52	-1.43
Spain	1.27	-0.12	0.21	-1.07	0.09	-1.18
UK	-0.17	1.18	-1.41	-1.24	-0.24	-0.06
Ireland	1.22	3.16	-1.87	-3.09	1.29	0.07
Netherlands	-0.49	2.11	-2.05	-1.56	0.05	0.54
Sweden	-0.29	1.06	0.81	1.10	1.87	2.16
Denmark	-0.09	1.33	1.11	1.20	2.44	2.53
Finland	0.00	0.44	3.75	3.76	4.20	4.20

Because the four cohesion countries receive a net contribution from the rest of the Union, the excess of expenditure over national tax income can go above 4% of GDP. On the other hand, net-contributors to the European budget are severely restrained in the borrowing capacity. In particular Germany, which has arguably significant amount of borrowing in order to finance the restructuring of public infrastructure in Eastern Germany, the borrowing capacity for national purposes is not 3%, but 2.74%. As a consequence of this arrangement the burden of fiscal discipline on national budget policies is inequitable and does not provide a regional insurance scheme for asymmetric shocks.

See Graph 4 and Ackrill (2004).

4. Integrating European and National Budget Policies

Our discussion of the European budget arrangements has revealed some serious shortfalls. An efficient European budget arrangement should provide vertical flexibility in order to deal with macroeconomic shocks that affect the whole of Euroland and horizontal flexibility that allows stabilization of asymmetric shocks. In addition, it should have a mechanism whereby the macro-economically relevant aggregate European budget position reflects the preferences of European citizens, rather than being the random outcome of more or less uncoordinated partial national interests. I have discussed these issues of European preference formation in Collignon (2002, 2003). I will now suggest how to overcome the described institutional shortfalls by the following arrangement.

4.1. Defining the Aggregate Fiscal Policy Stance

What matters for the macroeconomic policy mixed between monetary and fiscal policy is the definition of the aggregate fiscal stance of the EU, or at least with respect to the members of the EMU. Given that the bulk of expenditure is allocated by national governments, it would be necessary to define an aggregate fiscal policy stance (total public expenditure minus revenue) with respect to the economic conditions of the whole of EMU and then reallocate expenditure and deficit quota to each national jurisdictions for implementation. Within these quotas, each national government would then set the priorities reflecting the specific preferences for allocating collective goods within its jurisdiction while the macroeconomic aggregate would reflect the collective interests of all citizens concerned. This idea resolves the earlier mentioned dilemma, whereby the stabilization function of public finances needs to be efficiently dealt with at the central level, while the allocation function can respond to preference heterogeneity.

From a technical point of view this procedure is not unusual. For example, the French Parliament votes first a macroeconomic framework law and then the detailed item voting within the overall budget constraint ensures that individual preferences remain coherent with the overall stability requirement[8]. Similarly, Italy first defines a multi-annual macroeconomic framework law, the Economic and Financial Planning Document (known by its French acronym, DPEF), and subsequently the *legge finanziaria* implements the actual budget allocations (Amato 2000). In the European context, there exists an instrument that could be developed to serve an efficient budget process. One could redefine the Broad Economic Policy Guidelines (BEPG) to take the function of a binding annual macroeconomic framework

[8] In fact this arrangement was one of the essential innovations of the Fifth Republic in the fiscal policy side.

law. They would define the authorized aggregate spending and income of all EU public authorities, as they seem relevant from a business cycle point of view. As such they would effectively set the aggregate budget deficit of the EU for any given year. In a second part to the BEPG, one continues their present function of giving orientation and direction for supply-side reforms of the European economy with specific recommendations to Member States.

However in order to make these revamped Broad Economic Policy Guidelines a binding legal commitment that entitles the EU to superimpose budget requirements on national parliaments, it is essential that they have full democratic legitimacy. This legitimacy cannot be derived alone from the legitimacy of national governments as represented in the European Council. European citizens must be able to directly express, discuss and control their collective preferences and the instrument for this is the European Parliament. Hence the EU budget procedure should establish the aggregate European budget position as a framework law that is proposed by the European Commission and then voted by the European Parliament. Subsequently, it is agreed with the European Council in the co-decision procedure. The advantage of this arrangement is not only procedural. It also provides a public domain for the discussion of collective preferences with respect to the choice of public borrowing and the level of interest rates. It therefore would contribute not only to greater democratic legitimacy, but also to the construction of a European democracy.

4.2. Horizontal Flexibility

Once the aggregate fiscal policy stands as being determined, the allocation to national governments of the respective income expenditure and deficit quota has to take place. An obvious benchmark for the allocation of these quotas would be the share of GDP of the respective Member States. However, in addition it is necessary to have a mechanism to deal with deviation from these quotas when asymmetric shocks hit specific Member States. One method could be to leave this to negotiations with in the European Council. A more elegant way would be the introduction of tradable deficit permits (Casella 1999). Under this procedure each Member State would obtain tradable deficit permits in proportion to the deficits agreed under the macroeconomic framework law (BEPG). If a country chooses to borrow more it would have to buy additional deficit permits from countries who do not wish to use their own. In this way deficit permits actually ensure interregional transfers, without inter-temporal distortions. Furthermore, by making these permits tradable, the political option of borrowing versus taxing obtains a price that reflects the relevant scarcity of funds. It therefore invites a public debate and contributes to a democratic decision about the conduct of national budget policies in the European context.

4.3. Harmonizing European Preferences

The theory of fiscal federalism has also emphasized that the allocation function of public finances should be decentralized as far as possible, when collective preferences between communities are heterogeneous. However, as mentioned above, this theory largely ignores externalities and spillovers from one jurisdiction to another. Hence, the decisions on European public goods (although not on national goods) need to be taken at the EU level. The resulting welfare losses could be reduced and turned into gains, when collective preferences converge. As I have shown elsewhere (Collignon 2002, 2003, 2004), this can be achieved by deliberative democracy at the EU level.

The budget process can contribute to this preference convergence in significant ways. By deciding the macroeconomic policy framework law at the European level, it also becomes possible to integrate national budgets with the European budget. This implies that policy deliberation has to take into account the spillover of national policy decisions on other jurisdictions and ultimately on other citizens. First of all, by integrating the public expenditure of national governments with the European Union budget, a clear definition of the aggregate fiscal policy stance is determined. This allows optimizing the policy mix between aggregate fiscal and unified monetary policies to ensure macroeconomic stability. However, in order to disentangle national and European budget decisions it is advisable to give full budgetary sovereignty to the European Union institutions for their own budget. This implies that the European Parliament has authority over expenditure of the EU budget and taxing European citizens accordingly. This does not prevent setting limits to the EU budget's size, such as keeping the European budget below one, 2 or 3% of GDP.

Secondly, in order to disarm the disintegrating tendencies resulting from the fact that the EU budget is an item in the spending plans of national treasuries, the funding for European public goods should be obtained by a European tax levied on a European-wide tax base. This has the advantage that the disintegrative budget haggling that occurs every seven years when deciding the financial perspectives would cease, and a clear assignment of responsibilities for public expenditure would be assigned to the different levels of the EU.

5. Conclusion

With the additional claims on the EU's public finances resulting from enlargement, the dangers of political conflict and disintegration increase. What is required is a coherent fiscal policy that delivers the economic growth necessary to accommodate the expectations and has the democratic legitimacy of Europe's citizens. Inventing new ways for Europe's fiscal policy may be a rewarding enterprise.

References

Amato, G. (2002), "Verso un DPEF Europeo", *Nuova Economia Nuova Società*, No.4, July, p.15-19.

Ackrill, R. (2004), "Stabilization in EMU: A critical Review", *in* Baimbridge and Whyman (2004a).

Ardy, B. (2004), "The Development of EU Budgetary Measures and the Rise of Structural Funding", *in* Baimbridge and Whyman (2004a).

Artis, M. and M. Buti (2000), "Close to Balance or in Surplus: A Policy-maker's Guide to the Implementation of the Stability and Growth Pact", *Discussion Paper*, No.2515, Centre for Economic Policy Research, July.

Baimbridge M. and P. Whyman (eds.) (2004a), *Fiscal Federalism and European Economic Integration*, London/New York, Routledge.

Baimbridge M. and P. Whyman (2004b), "Introduction. Fiscal Federalism and EMU: An Appraisal", *in* Baimbridge and Whyman (2004a).

Barro, R. (1974), "Are Government Bonds Net Wealth?", *Journal of Political Economy*, No.82, p.1095-117.

Bini-Smaghi, L., T. Padoa-Scioppa and F. Papadia (1994), "The Transition to EMU in the Maastricht Treaty", *Essays in International Finance*, No.194, New Jersey, Princeton University, November.

Buti, M. (ed.) (2003), *Monetary and Fiscal Policies in EMU – Interaction and Coordination*, Cambridge/New York, Cambridge University Press.

Canzoneri, M.B., V. Grilli and P.R. Masson (eds.) (1992), *Establishing a Central Bank: Issues in Europe and Lessons from the US*, Cambridge/New York, Cambridge University Press, CEPR and IMF.

Casella, A. (2001), "Trade-able Deficit Permits", *in* A. Brumila, M. Buti and D. Franco (2001), *The Stability and Growth Pact. The Architecture of Fiscal Policy in EMU*, London, Palgrave.

Collignon, S. (2002), "Les conditions politiques et institutionnelles d'une coordination des politiques économiques dans l'Euroland", *Revue d'économie financière*, "Trois ans de politique monétaire européenne", No.65. English version: *Economic Policy Coordination in EMU: Institutional and Political Requirements*, Center for European Studies (CES), Harvard University, May 2001.

Collignon, S. (2003), *The European Republic – Reflections on the Economy of a Future Constitution*, London, The Federal Trust.

Collignon, S. (2004), "Is Europe going far enough? Reflections on the EU's Economic Governance", *Journal of European Public Policy*, Vol.11, No.5.

Delors Report (1989), Committee for the Study of Economic and Monetary Union,. *Report on Economic and Monetary Union in the European Community*, Luxemburg, Office for Official Publications of the European Communities.

ECB (2004), "Fiscal Policy Influences on Macroeconomic Stability and Prices", *Monthly Bulletin*, April.

European Commission (2003), "Public Finances in EMU", *European Economy*, No.3, Brussels.

Fatás, A. (1998), "Does EMU Need a Fiscal Federation", *Economic Policy*, No.26, April, p. 163-203.

MacDougall Report (1977), EC Commission, *Report on the Study Group of Public Finance in European Integration*, Luxemburg, Office for the official Publication of the European Communities.

Musgrave, R.M. (1959), *The Theory of Public Finance*, New York, McGraw-Hill.

Oates, W.E. (2004), “An Essay on Fiscal Federalism”, *in* Baimbridge and Whyman (2004a).

Schelkle, W. (2002), “Disciplining Device or Insurance Arrangement? Two Approaches to the Political Economy of EMU Policy Coordination”, *Working Paper* 200-01, December.

European Tax

NICOLAS-JEAN BREHON[1]

The debates about the coming European financial framework 2007-2013 will mainly focus on the amount of the future community budget, the relative importance of different expenditures and the distribution of tasks between Member States. It is unlikely that the financing mode be called into question. Every initiative concerning this subject will be even better accepted, that is why its implementation will be postponed… This situation is regrettable. During the last decade, the builders of Europe have made deepening and widening works at once. The principal flaw in the European construction, so much cruel, is in its citizenship. Europe often leaves its visitors indifferent and bored. This is its principal peril. No occasion to remedy this situation, should be wasted.

It is in this perspective that European tax, destined to finance the community budget, should be discussed. What are the justification and feasibility of European tax, in other words: A European tax, what for and how to do it?

1. A European Tax, What For?

A European tax can be justified with reaction regarding the current system, as well as with adherence to the project in itself.

1.1. Critical Assessment of the Current System

The current system of community budget financing does not only have disadvantages, but it failed in its search for autonomy compared to Member States and its methods are disputable.

[1] Nicolas-Jean Brehon is a teacher of European Finances at Paris I-Sorbonne.

1.1.1. The advantages of the current system

The current system of financing through "personal resources" is ambitious in its principle[2], practical in its methods[3], and encouraging in its results[4].

While Member States are confronted with the difficult control of the budget deficit, the EU has a guarantee of resources. The only limit to the levies is a ceiling fixed by the Member States in proportion with the community GNP/GNR (today 1.24% of the community GNR).

The system also presents the practical advantage of being completely painless. If, according to the maxim attributed to Colbert, "Taxation art consists in plucking the goose with the minimum squeals possible", then Europe has perfectly succeeded in conciliating the two, by being financed without being noticed by anyone ever.

Despite these assets, the current system presents numerous disadvantages: except for import duties, there are no personal resources.

1.1.2. The system has failed in its principles

The personal resources have always been considered as "an obvious false notion". Two acceptations were possible. The first one, political, ambitious, aimed at guaranteeing the financial independence of the EU towards the States. The personal resources would have been disconnected from those of the Member States, decided by the EU, applied to common policies, and, why not, imposed by a European fiscal administration. None of these ideas has succeeded. The personal resources of the EU are simply imposed on the fiscal resources of the Member States and therefore are not any different from the national contributions they were supposed to replace.

The other conception, mechanical, consisted of organizing a certain automaticity of the payments to the community budget. The revenues are automatically paid by the States to the

[2] According to the terms of the article 269 of the EC treaty, "The budget is fully financed by personal resources". This notion is maintained in part I, article 53, paragraph 2 of the project of Constitution.
[3] It is the case of the rule of the automatic equilibrium of the budget: the revenues adjust to the expenses. In the current system, we perceive the traditional personal resources (custom duties and agricultural duties), the VAT resource, and the GNP resource. This latter provides the function of a buffer resource and is calculated by the difference between the expenses and other personal resources.
[4] The creation of the GNP resource in 1998 was accompanied by a remarkable budgetary peace between the two branches of the budgetary authorities. It has ensured the financing of the community budget, while connecting the part of the States with their part in the wealth of the Union.

community budget. These latter do not have the choice, because they are Community resources. This conception is backed up by a constant jurisprudence of the European Court of Justice that imposes sanctions on Member States for every delayed payment for personal resources.

This automaticity, which endowed the community budget with a certain kind of independence, collided however with the initiative of national parliaments. Since 1993 in France, the article of the Finance Act given the title of "evaluation of the French participation to European communities' budget" is subject to debates and voted by the parliament as any other article of the Finance Act. The vote of community personal resources by a national parliament is the ultimate step of the renationalization of the system and the end of the myth. If the designation remains, the initial ambitions of the treaty of Rome were swept away. The personal resources were supposed to make the community budget financing independent from the Member States, but it is not so.

1.1.3. The system has failed in its modalities

Can we still talk about personal resources when the installed system, reform after reform[5], moves further away? It is barely to caricature the situation than to say that the whole system relies on the "true false".

– True false personal resources since these resources are simply imposed on the revenues of Member States and repaid to the community budget following a vote by the French parliament.

– True false VAT, since the VAT resource is neither a value added calculated tax on the model of Member States, nor a rate added to the VAT rates in the States, nor even a part of the product of the national VAT. Its amount is not imposed on the national VAT, but on the product of the fiscal revenues of the Member State. The VAT resource is nothing but a disguised contribution to the GNP. The name "VAT resource" leads to suppose the existence of a link with the debtor, but the "link with the debtor is only symbolic"[6].

– True false GNP resource that is not a national contribution the function of which is limited to the equilibrium of the community budget.

[5] The system of personal resources provided for in article 201 of the Treaty of Rome, has been installed by the decision of the Council of September 21, 1970, and modified for five times. The present regime is provided for by the decision of September 29, 2000.

– Finally, the computing modalities are, except for custom duties[7], in a way that personal resources do not present any of the characteristics of community taxation. A tax supposes a tax base, a rate, and a debtor. Personal resources lack in minimum one element[8].

1.2. Advantages Expected from a European Tax

Why change a system that has functioned in an overall satisfactory way for thirty years, and that ensures sufficient receipts to finance the expenditure of the Union and from which nobody complains? A European tax would unquestionably be an effort and even a constraint. However, some reasons of principle as well as institutional and budgetary factors can support this evolution.

1.2.1. Justifications based on principles

• The assent to the tax

One of the basic principles of every democracy is the assent to the tax. The application made by it in Europe can only give rise to numerous reserves. The situation is at the very least complex. While each year, the national parliaments vote the tax rates and the receipts intended to finance all or part of the public expenditure, in the EU, competence with regard to receipts differs according to whether it is a question of determining the nature or the categories of the resources, the methods of the resources (methods of calculation and installations of the contributions of the Member States), the ceiling not to be exceeded, and the amount of the levied resources… The series of rules is summarized in the following table.

[6] Gérald Godet, "The community personal resources", *Revue française des finances publiques*.

[7] Custom duties are the only true community taxes, since the tax base is defined by the value of imported goods, the rate is fixed by the Commission (by the delegation of the Council), and the debtors are clearly identified seen that they are the importers. In addition, custom duties constitute one part of the European commercial policy.

[8] With regard to the VAT and the GNP resource, the debtor is not a physical person, it is the State; the rate of the VAT resource varies depending on the State and the call rate of the GNP resource varies according to the product of other resources; besides the tax base of the GNP is secondary, since the importance does not reside in the tax rate that can evolve indifferently, but in the product that should be perceived.

Table 1. Summary Table of Competences with Regard to Personal Resources

	Nature and ceiling of the resources.	Modalities of resources	Annual amount of resources.
Treaty (art. 269)	1/ Commission proposal 2/ Political decision of the European Council 3/ Council Decision, *unanimously* after *consultation of the EP* 4/ Decision approved by the MS (*ratification authorized by the national parliaments*)	Idem	Results from the vote of expenditure. 1/ Commission proposal 2/ Budgetary procedure with role of the Council ruling by the qualified majority, during the fixation of the obligatory expenditure and role of the EP in the fixation of the non-compulsory expenditure
Project of Constitution (art. 53)	1/ Commission proposal 2/ Political decision of the European Council 3/ Law of the Council, *unanimously* after *consultation of the EP* 4/ Law approved by the MS (*ratification authorized by the national parliaments*)	1/ Commission proposal 2/ Law of the Council, by the qualified majority, after approval of the EP	Results from the vote of the expenditure 1/Commission proposal 2/ Budgetary procedure (art. III-310), dominating role of the EP in the fixation of the expenditure

Note: in italic: practices not expressly envisaged by the texts, but acquired (treated) or probable (project of Constitution).

Shall be increased the difference between the precautions taken at the time of the choice of the type of resources and the fixation of the ceiling of the resources, still very largely subject to the control of States[9], and the almost absence of any control thereafter at the time of fixing the amount of the levy. Thus, it can be considered that the first decision concerning the personal resources will to some extent constitute a drawing right on national finances, a white signature which will remain valid as long as the decision is not modified. The EP intervenes only for consultation. The assent to the levy is given by the governments (the European Council and the Council) and by the national parliaments (which authorize the ratification) but once and for all. Thus, everything takes place as if, once the decision of levying the resources was taken, nobody vote for them any more, neither the EP, nor the national parliaments. That is a subject to be discussed… The budgetary operation of the Union does not appear worthy of a modern democracy.

• The European tax could contribute to the emergence of a European citizenship

A citizen is a member of a political community, profiting from prerogatives and assuming the responsibilities attached to this membership. The citizenship has always mixed rights and constraints: constraint of blood (in times of war), of time (military or civil service), and of

[9] Three bolts are envisaged: a decision of the only Council – instead of a joint decision of the Council and the EP –, unanimously – instead of the qualified majority –, and the authorization of ratification by the national parliaments.

money, by the tax. The tax was always an element of identification, a vector of membership, and the elementary form of the citizen constraint. Always and everywhere… except in Europe.

The inhabitants of the same commune, department, area, or State, all pay local (communal, departmental, regional) and national taxes. Europe is the only institutional level not to impose its citizens. The applications of the concept of European citizenship are still limited[10]. It remains to build this identity, this feeling of belonging (which mixes between the emotional feeling and the constraint) without which the EU would be never other than a big market. The European tax can be one of the vectors of this identity and an element of citizenship.

1.2.2. Advantages of a political nature

The European tax would also make it possible to clarify the political responsibilities. The current system does not satisfy anybody and leads to a dilution of the responsibilities. The members of Parliament, French and Europeans, often complain for the same reasons, because each one complains of having been removed.

No logic was pursued to its end, neither that of the autonomy of the Community budget, nor that of the national control. In the beginning, "the national parliaments were dispossessed of their prerogatives with the EP being unable to take over"[11]. In the second place, the vote of the personal resources by the national parliaments is a challenge to the EP while at the same time the procedure is meaningless. Because the vote of the French participation in the Community budget remains imposed since they are resources necessary to the balance of the Community budget. The amendments, deposited and discussed, cannot be adopted.

A nevertheless distressing emptiness, since it does not exclude the possibility of a blocking. "The absence of a European tax exposes the Union to the blocking of a part of its resources by a national parliament. Indeed, this blocking never occurred to date but the risk will remain as long as the vote of the transfers of receipts will concern the simple rite, the members of Parliament being bound by the decisions of their government. That such a vote, opposite to the treaties, engage the pecuniary responsibility of the concerned Member State, would not prevent the emergence of a major political crisis"[12].

[10] The civil rights of the European citizen defined by the treaty constitute the right to circulate and stay on the territory of the Union, the rights of voting and of eligibility to the municipal and European elections, the right of diplomatic and consular protection, the right of petition and call to the mediator.
[11] Jean-François Bernicot, *Revue française des finances publiques*, n° 80.
[12] Montaigne Institute, *Towards a European Tax*, October 2003.

Eventually, the national parliaments vote receipts that finance expenditure that they do not control, while the EP votes expenditure without having to worry about their financing. Can we build a European citizenship based on such principles?

1.2.3. Expected advantages of a budgetary nature

It is first advisable to raise an ambiguity. The European tax is not justified by financial reasons in order to provide resources. The current system perfectly ensures the financing of the Community budget and the GNP resource, which is a national contribution that is completely elastic and can answer any possible increase in the European budget. Contrary to a common idea, there is no exhaustion of the personal resources since the principal one of them is related to the GNP.

The budgetary justifications are of another kind. The current system is at the same time opaque and deviating.

• The exaggeratedly complex system distorts the perception of the Community budget

The mode of financing keeps the populations in ignorance. This situation would not be too serious – after all, the opinion, as a whole, hardly knows more about the national budget – if it was not doubled by drifts that are more pernicious.

The Community budget is perceived like a budget of redistribution, a kind of vast machine to distribute assistances to farmers or areas. A perfectly normal situation since nobody knows how it is financed! Thus, the institutional choice of creating an expenditure budget, to which resources automatically adapt, resulted in a decoupling between the European expenditure, vaguely known, and their financing, completely ignored. Why not, ask the Community budget for more for the time being, since nobody worries about the financing? The mode of current financing encourages an irresponsible behavior.

• The system favors the purely countable approach of the financial bonds between the States and the budget of the EU

The participation in the Community budget is a contribution of the State, levied on its fiscal revenues. This situation inevitably favors calculations in terms of returns. It is simple and tempting to calculate how much a State pays to the Community budget and how much it

receives in return. This type of calculations makes it possible to establish net balances, and to position itself among the net beneficiaries of the Community budget (those of which the returns are higher than the contributions) or among the net contributors (those whose contributions are higher than the returns).

This accountancy is expressed on the political level, by supporting the debates on the just return, when a State considers that its net contribution is excessive. Mechanisms of budgetary correction, in contradiction with the principle of solidarity always called serious reserves, but have multiplied[13] and are likely to be at the center of the negotiations of the future financial prospects 2007-2013. The released net balances are used as a basis for the requests of current and future corrections.

The system of personal resources, as it functions today, is partly responsible for this drift. A European tax, which would directly strike the citizens or the economic agents, would badly lend itself to these calculations of returns. The citizens, the companies of a department or an area do not calculate if the national expenditure in the said department or area corresponds to the taxes that they paid. The tax breaks the logic of regional accountancy. Indeed, it would be always possible to carry out these calculations, while seeking to evaluate what the citizens, the companies of a State pay to the Community budget and while deducing what the territory receives in return, but such calculations would lose in force and relevance.

The European tax will dominate since European solidarity – and solidity – will be put to the test with widening. It is advisable to prevent these periods of uncertainties and to think of mechanisms of financing which will avoid the meanness and the implosion.

[13] A mechanism of correction to the profit of the United Kingdom, in the form of a reduction in the British contribution to EU budget, was adopted in the European Council of Fontainebleau in 1984. This reduction is financed by the other Member States. A new correction was introduced in 2000 to the profit of four Member States in the form of a reduction of their participation in the financing of the British correction.

2. Modalities of the European Tax

Despite of this interest, argued many times, the European tax has never imposed itself. It is advisable to have an update on the obstacles – there are really numerous but not irreducible ones – to the implementation of a European tax.

2.1. Assessment of Initiatives

2.1.1. Projects and initiatives

The interventions supporting the idea of a European tax are recurrent and the propositions are numerous. These initiatives cannot surprise, with regard to European members of Parliament who live in the double frustration of being excluded from the decision-making process in the field of the personal resources and to have been in a gradual competition with the national parliaments[14]. However, these initiatives can also be found in the States. Some national members of Parliament express themselves regularly on this subject. In France, the Economic and Social Council have developed same proposals[15]. Several ministers have also expressed their opinion in this regard[16].

The most advanced technical propositions emanate from the European Commission[17]. It makes the census of the five criteria applicable to possible news resources: appropriateness of the resource to the needs for financing (what supposes an important and stable resource), equity of the contributions (in order to distribute fairly the load between the Member States), financial autonomy (in order to return the EU budget independent from the public nationals treasures), transparency and simplicity, good cost ratio/effectiveness. It also details various possible options: a modified VAT resource, the tax on corporations or on the revenues, a tax CO_2/energy, a tax on communications, excise duties…

None of these projects came to its end. The oppositions are still significant. The force of the arguments is however variable.

[14] See resolutions of the EP particularly of March 11 and July 5, 2001. In 1998, the President of the EP, J.-M. Gil Robles, also expressed himself in this subject – speech from October 24, 1998 in Portschach in Austria.

[15] George de la Loyère, "Necessary evolutions of the financing of the European Union", Economic and Social Council, 2003.

[16] Pierre Bérégovoy, then French Minister of Economy and Finances in 1992, German and Belgian Ministers of Finance, ten years later

[17] European Commission, "Financing of the EU", report on the operation of the system of the personal resources, October 7, 1998

2.1.2. The evoked oppositions

• Budgetary arguments

– The technical arguments are the least relevant. No tax answers all the conditions set out by the Commission: simplicity, equity, autonomy, effectiveness, output… It is true that the ideal European tax does not exist. But that is true for any other tax. The argument on the cost of perception of a European tax is ridiculous. A European tax could be perfectly perceived by the national tax authorities, as it is the case for local taxes.

– The coherence of the proposition of a European tax is also evoked. One can indeed observe that the European tax exists already, in the form of customs duties and that it is precisely the only one that has been systematically lowered for a few years[18]! There is thus some impudence to propose a new true European tax whereas the one that exists was systematically reduced!

• Political arguments

– These oppositions, which emanate mainly from the national members of Parliament, relate to the place and the role of the EP. Many national members of Parliament consider the European tax as a threat. They fear the dispossession of a traditional parliamentary competence[19] and the concomitant reinforcement of the powers of the EP to the detriment of that of the Member States. It would not be denied being that the EP – at least in France –, found its place neither at the heart of French people nor in the institutions. Many national members of Parliament consider their EP colleagues with condescension. The mode of selection of the candidates, the mode of election of the deputies, the operating mode of the EP are characteristics which handicap the EP.

– This criticism is doubled by a fear of budgetary drift insofar as the EP is readily considered irresponsible and too permeable to the modes and the anecdotic expenditure. The European tax would do nothing but reinforce this drift-supposed natural of the EP.

[18] Either under the effect of the international negotiations, or by choice, since in 2000, the percentage preserved by the States at the title of the expenses of perception passed from 10% to 25%.

[19] If the EP has more capacities out of matters of expenditure than the national parliament, the situation is opposite as regards receipts. In France, the competence of the Parliament in the tax matter is still very preserved and its capacities are wide: the Parliament can found a new tax, reduce an existing tax, to substitute a tax for another, oppose with the creation of a new tax.

– Finally, the European tax introduces incontestably an amount of federalism. The fear of a "federal drift" appears however somewhat exceeded whereas the currency unique made up a stage and an abandonment of sovereignty differently more symbolic systems and considerable that a possible European tax. On the other hand, two obstacles appear really determining.

2.1.3. True obstacles

• The first obstacle is of legal order

Any reform on the financing requires unanimity. The current rules of financing are marked by an extreme prudence and the "three bolts" (decision of the only Council + unanimity + approval by the national parliaments) reveal the hesitations of the Member States to give up the minor piece of power in the field of taxation and financing of the Community budget. Since May 1st, 2004, any reform requires the agreement of the Twenty-five Member States. Even an agreement on the higher level of the State would not be sufficient, insofar as the revolt of only one Parliament would be enough to block the reform.

• The second obstacle is related to the difficulties of communication

As would have observed it Laurent Fabius, then French Prime Minister, "we have never seen a demonstration claiming a European tax". The perspective of having a European tax hardly arouses the enthusiasm of the citizens. The difficulty is of pedagogic order but it is considerable. It would be moreover much easier to oppose to a European tax on the topic "a new tax" than to explain than the Community resources result from the series of the fiscal resources levied from the citizens, who, in fact, already pay for Europe but without knowing it.

The current system is certainly opaque but it is painless. Besides, it is not sure that the citizen prefers a system certainly more readable to him, but where the financial puncture is also marked. The opposition to the European tax is extremely simple and accessible. The defense of the European tax is difficult, subtle, demanding. The battle of the communication is undoubtedly lost in advance.

2.2. Possible Openings

In spite of a situation objectively not very favorable to the fiscal initiatives of this type, some openings appear possible.

2.2.1. Certain factors are favorable to the resumption of the debate

• The widening of 2004

Widening will constitute a budgetary disruption still badly apprehended. Widening works transform the shape of the Union, increase the distinction between poor countries and rich countries, and will lead to delicate modifications in the structure of the Community budget, marked by the priority of the policies of cohesion in direction of the poor countries. The Member States, especially the principal contributors, will be very vigilant to the evolution of their budgetary position and the ritual debate on the net balances and the British correction will be even sharper than usual[20].

The system of the national contributions will inevitably lead to countable calculations of tradesmen in order to know who pays for whom, who pays more than others… The Commission proposition of founding a generalized mechanism of crest lowering of the net balances will lead to budgetary bargains, seeing that the variables of calculation are numerous. Whereas European construction is an extraordinary ambition and project, these ridiculous calculations can only give one disastrous image of Europe. Any solution substituting to the national contributions and that would allow the avoidance of these drifts, will have to be encouraged!

Widening constitutes a challenge and an opportunity, perfectly perceived since 1998, since the Commission, in its report on the financing of the European Union, anticipated that: "widening would constitute a change of situation such as it could provide the occasion of a structural reform of dimension".

[20] This system of correction could be justified in its time when budgetary imbalance concerned a relatively poor country, as it was the case for the United Kingdom in the 1970s. The system becomes completely iniquitous when it applies to a country that became rich (the standard of living is 20% superior to the new Community average) which manages to make finance its imbalance by the other States including the poorest States. For a critic of the British mechanism of correction, see Marc Laffineur and Serge Vinçon, “Report to the Prime Minister on the future European financial prospects 2007-2013”.

• The EU at a standstill and on standby

The other element likely to cause initiatives is the economic and financial context. The European model is at a standstill.

At a standstill of growth in the first place. Whereas the economic outlooks announced at the European Council of Lisbon on March 23-24, 2000, were to be "the best since a generation", the European growth was worst of the last decade…

At a standstill of credibility in the second place. The opinions on the EU are contrasted. The widening of 2004 is the first to which we associate a fear of relocations of activity. The fight of the States, of the areas, to attract or preserve work will be increasingly hard. Fiscal competition was and will be one of the means of action of the States.

At a standstill of project in the third place. What is the European project? That we do not mistake, obviously, in any case the European tax cannot be this mobilizing project that Europe needs! But it can accompany it. The European tax of will be better accepted than it is associated to something new, something useful, and expected.

2.2.2. Possible technical tracks

The European tax can emerge only after some precautions

The pitfalls should be initially avoided:

– The pitfall of the innovation and the unknown, as it would be the case of a completely new tax; the transfer of an existing tax is without any doubt preferable at the time of creation of a new tax. One should not seek the ideal tax – that does not exist – but the possible one;

– The pitfall of the assured conflict (certain taxes appear untouchable like income tax, politically too delicate, or the tax on the pollutant emissions, also too conflicting because of the fiscal treatment of the production of electricity of nuclear origin);

– The pitfall of the gadget, of the symbolic personal resource and without output (rights of seigniorage on the benefit of the central banks).

It is also necessary to reassure:

– To reassure by keeping limits. The budgetary fear of drift can be perfectly controlled while preserving, at least temporarily, a ceiling, fixed either by the States, as it is the case today, or in PE/Council joint decision;

– To reassure by privileging the possible and existing one: why not keep a mixed system, which would combine European tax and national contribution, as it is the case today?

– To reassure by privileging simplicity. From this point of view, the VAT has undeniable advantages. The advantage of the VAT is to already have a base standardized in Europe, which makes it a possible European tax being able to be easily implemented in the form of additional VAT rate at the national rates for example. The argument according to which the VAT, tax of consumption, penalizes the poorest can be attenuated by imagining a double rates system according to the richness of the country.

• To couple the tax with a European object

One of the tracks of creation of a European tax would tend to privilege the identity function of the EU. That ensures relatively little functions on a purely exclusive basis: the commercial policy is one of its missions. The EU is still defined by borders and this characteristic can be perfectly made profitable to found fiscality.

The customs duties grow blurred but the border remains. The customs are collectors of European tax but also many other taxes that are perceived at the time of the entry of the goods – VAT on imported products and excises[21]. These rights could perfectly be personal resources of the Community budget.

• To couple the tax with a European objective

The European tax can also work towards an end, economic and political, of regulation of the market. Several can be considered.

[21] In France, of the 62 billion Euros rights and taxes collected by the customs in 2002, 24 billion are resulted from the inland duty on the petroleum products, 15,3 billion come from the VAT collected on the imported products. The transformation of the VAT collected by the customs into personal resource of the Community budget would be effective and technically easy to realize.

– The EU *must avoid tax competition between the Member States*. The levels of income tax of the companies are factors of localization of the social headquarters and factors of industrial relocation. The companies were the first beneficiaries of the freedom of the exchanges and capitals, and it would not be illogical that they contribute to the Community budget. This way is often recommended today.

However, the difficulties, policies and techniques, should not be masked. On one hand, the European tax on the companies hardly offers the expected visibility and the citizens will quickly ignore a tax that they never really consider as theirs. In addition, the level of the benefit and consequently the product of the imposition are very dependent on the structure of financing of the companies (by capital contributions or loan), which varies a lot depending on the States. A possible European tax on the companies would thus strike the companies differently, regardless of fiscal neutrality and equity.

These difficulties should not block the propositions. Initially, the EU must be getting down to harmonize the taxation amounts and to found an applicable minimum rate in the all of the Union. This approach would be coherent with a lawful effort aiming at reducing the disparities between the States. The transfer of this tax to the Community budget, which is a distinct subject, could be considered in the second time.

– In addition, the EU engaged in the *environmental protection*. It must anticipate the evolutions. Europe undoubtedly does not pay sufficiently attention to the consumption of fossil imported energy, particularly the oil, whose prices will be pushed by the Asian development. All that can be made to reduce this energy dependence (by renewable energies and the nuclear energy) must be encouraged. A tax on the consumption of energy and/or the oil imports could be a track to be explored[22].

– Finally, the tax can be also conceived as an *element of market regulation* and to tax activities that developed until now without forced rules or constraints. In order to support the domestic market and to fight against the delocalizations of activities outside the EU, why not imagine a profit tax on relocated activities? The fiscality must also evolve with the technology. Thus, a recent senatorial report proposes the instauration of a tax on the receipts resulting from the TV retransmissions of the football matches…

---

[22] The principal rights and taxation weighing on the oil imports are a specific tax on the petroleum products – in France the petroleum products inland duty, PPID – and the VAT. In France, the PPID

• Evaluation test

Two ways seem to draw. One would tend to privilege the identity function of Europe and would be based on resources levied on the borders (percentage on the PPIS and/or VAT on imports). The other would start from the most tangible result of the European construction: the single market (VAT and the corporation tax). It will be observed that in all the Union countries, all these taxes have high outputs. The swing of a fraction of these taxes on the Community budget would thus be largely enough to finance this latter.

These two ways are not exclusive one from the other. Various assumptions can be quantified: either a single tax (hypothesis 1, 2 and 3), or a combination of taxes (hypothesis 4).

Table 2. Financing of Budget EU by New Personal Resources
(The French case; data 2004, billion Euros)

Tax	Product 2004	Hypothesis 1: Border taxes		Hypothesis 2: Inland market taxes (+custom duties)		Hypothesis 3: Energy taxes (+custom duties)		Hypothesis 4: Border mixed taxes, energy and inland market	
		Rate (%)	Net product (milliard €)	Rate (%)	Net product (milliard €)	Rate (%)	Net product (milliard €)	Rate (%)	Net product (milliard €)
VAT	144.7			5	6.5			4	5.8
ST	48.8			19	8.3			10	4.4
PPIS	25.8					63	14.8	20	4.6
VAT imported products	15.3*	100	13.9		1				
VAT petroleum products	6.5*				15.8				
Custom duties	1.3*	100	1		15.8	100	1	100	1
Total			14.9				15.8		15.8
EU levy	15.8		15.8				15.8		15.8

Sources: VAT, ST, and PPIS: PLF 2004, evaluation of the ways and means, forecasts 2004.
* VAT imported products, oil and customs duties products: customs assessment 2002.
Net product = gross product minus earnings for expenses of perception is by hypothesis, 10% for all the taxes and 25% for the customs duties.

2.2.3. The political opening: to bind the European tax to a European public property

The European tax must be based on realism and ambition. It is at the same time necessary to avoid certain pitfalls and to reassure, but also to find with this tax a powerful legitimacy. The European tax cannot be exclusively intended to provide receipts to the Community budget but must correspond to a political objective. One can imagine to couple the European tax with a function, a goal, or better still a specifically European public property.

---

brought back 24 billion Euros in 2002 to which it is necessary to add 6,5 billion of VAT. Half of these two taxes would allow to honor the French contribution to the Community budget…

It would be its principal justification. This legitimacy will be assured if the tax is associated to a collective property of which Europe is in need. The citizens are ready to pay if they perceive a counterpart to their financial effort. To pay for the French or Spanish farmers or the poor areas of Italy and Poland is not likely to mobilize the opinion. On the other hand, in the current world, safety – interior and/or external – is a call and a collective request. The European tax will be essential when the EU will be able to show a collective project like the embryo of a European defense for example could be.

The European tax is technically possible and politically desirable. The true key of the European tax resides in the definition of a true European project, which supposes before anything else, an entire political will.

Part Four

Three Alternative Scenarios for the European Budget in 2013

Three Alternative Scenarios for the European Budget in 2013

MAXIME LEFEBVRE[1]

The proposal put forward by the European Commission for the European Union's financial perspectives for the period 2007-2013 is based on several choices: it goes beyond the 1% European GNI limit fixed by the major contributing countries; it foresees the creation of a corrective mechanism to correct the negative balances of contributing States; it preserves the great common policies (agricultural policy, regional policy) while at the same time putting forth new priorities (growth supportive policy; area of freedom, security and justice).

Alternative scenarios could be developed according to varying priorities and by playing on the level of European expenditure as well as on the allocation of this expenditure. They could be compared to the Commission's scenario, described in its contribution as "The European Budget at the Test of Enlargement".

Three scenarios are proposed for 2013. Given that Member States would be less willing to go beyond, they all hold within the 1-1.15% GNI in payment credits. It has moreover been admitted that the volume of agricultural expenditure (for the section direct payments and market expenditure) was fixed for the period 2007-2013, in conformity to the 2002 decision of the European Council. Indeed, it would have been possible to envisage a decrease in agricultural expenditure through the establishment of a method of "co-financing" through national budgets. Finally, each scenario holds on to 15% of the non-distributed expenditure as a part of administrative and external action expenditure.

The three scenarios that shall be taken into consideration are:

– a *"conservative" scenario* where the European Union's budget remains limited to 1% GNI and where a broad regional policy is favored over "new" politics aimed essentially at competitiveness;

[1] Maxime Lefebvre is the Head of European Affairs at Ifri.

– a *“competitiveness-solidarity” scenario* which also remains within the 1% GNI limit, but which gives priority to competitive expenditure while regional policy remains mainly concentrated on poorer countries;

– finally, a *“European public goods” scenario* which aims at a 1.15% limit but which also aims at developing European integration through the creation of a “defense fund”, while at the same time increasing competitive expenditure and reducing the distributive function of regional policy; this scenario is also aimed at offering a solution, other than the generalization of the corrective mechanism, to the problem of net balances.

As in the contribution on “the European budget at the test of enlargement”, the author has chosen to calculate “real” net balances that are based on the entire European Union’s budgetary expenditure, and not on the calculation of “operational” net balances carried out by the European Commission (which bases itself uniquely on operational expenditure and excludes administrative and external expenditure). The sum of “real” net balances is negative and corresponds to the administrative and external expenditure, non-distributed between States. This leads us to overlook the economic and financial benefits of administrative expenditure for countries such as Belgium and Luxemburg, and the benefits of external expenditure, for all Member States, if the European Union were to refuse carrying out such expenditure (development aid, humanitarian aid, post-conflict reconstruction assistance, etc.).

The estimations and simulations carried out in these scenarios are based on hypotheses that introduce the elements of uncertainty into the equation. However, the patterns that emerge could offer useful indications and help in the decision-making process.

1. Conservative Scenario

In this scenario, the envelope of the European Union’s budget is limited to 1% GNI 2013, as wished by the “letter from six”, *i.e.* 124.4 billion Euros in payment credits instead of 143.1 billion.

1.1. The Distribution of Expenditure

The "conservative" scenario preserves a strong agricultural policy as well as a strong regional policy, at the expense of other policies that aim to enhance the European Union's competitiveness.

Competitive expenditure (former "internal politics" section) shall be maintained at the same level as where it shall be in 2006, *i.e*. 7.3% of the Union's budget (Instead of 16% in the scenario presented by the Commission for 2013). This would total up to 9.06 billion Euros.

Agricultural expenditure shall be maintained at the same level as in the Commission's proposition, with a very slight packing down of expenditure concerning rural development. The distribution of sums in the above matter remains identical to that specified by the Commission's proposal.

Cohesion expenditure also follows trend and is at the same level as that proposed by the Commission, with a very slight packing down (45 billion Euros). Its distribution is not modified, and thus helps maintain an important effort in favor of old Member States.

Non-distributed expenditure would then amount to slightly less than 15% of the EU's budget (18.44 billion Euros) and shall cover administrative and external expenditure.

On the whole, this scenario allocates a high percentage of its expenditure for new Member States (30% as opposed to 27% as described in the Commission's scenario). The total net cost of enlargement for old Member States would thus remain higher than 75 Euros per person per year.

Table 1. Conservative Scenario: Distribution of Income and Operational Expenditure in 2013
(payment credits, 2004 prices)

	Income		Competitiveness expenditure		Cohesion expenditure		Direct agricultural expenditure		Rural development expenditure	
	%	Million €	%	Million €	%	Million €	%	Million €	%	Million €
Germany	21.30	26,493	13.86	1,255	9.40	4,230	11.28	4,308	8.56	1,173
UK	17.21	21,403	13.86	1,255	2.90	1,305	7.68	2,933	4.09	560
Italy	12.93	16,081	10.23	927	6.20	2,790	10.32	3,942	7.31	1,002
Netherlands	4.56	5,669	5.95	539	0.70	315	2.16	825	1.08	148
France	15.53	19,321	12.74	1,154	4.40	1,980	17.76	6,784	9.28	1,272
Sweden	2.51	3,124	2.98	270	0.60	270	1.52	581	0.78	107
Ireland	1.12	1,388	1.58	143	0.60	270	3.04	1,161	1.87	256
Portugal	1.30	1,620	1.67	152	3.10	1,395	1.68	642	2.66	364
Greece	1.40	1,735	3.26	295	5.40	2,430	5.04	1,925	5.83	798
Spain	6.98	8,677	5.67	514	13.20	5,940	11.92	4,553	12.12	1,660
Austria	2.14	2,661	2.51	227	0.70	315	2.00	764	1.04	142
Other old members(4)	6.05	7,520	18.69	1,694	0.80	360	5.60	2,139	2.89	396
New members (12)	7.00	8,708	7.00	634	52.00	23,400	20.00	7,639	42.50	5,823
Total	*100.00*	*124,400*	*100.00*	*9,060*	*100.00*	*45,000*	*100.00*	*38,196*	*100.00*	*13,700*

1.2. Analysis of Net Balances

According to the Commission's report, this scenario improves the net balance situation of all net contributors, with the exception of the Netherlands and Sweden. The "other old States" category is a clear loser, given the markedly high rate of return for these countries (especially Belgium) insofar as "internal policy" is concerned: their global rate of return decreases in a scenario which allocates less resource to such policy.

The poorest countries will receive significant assistance in the conservative scenario, with 3.3% of their GNI for new Member States (hardly less than in the Commission's scenario). Spain will see a slight improvement in its situation whereas the other three old countries of the "cohesion" will face minute losses.

The question of equity in financing remains unscathed in this scenario. The United Kingdom remains the biggest contributing State and would wish to maintain its "cheque".

Through the application of the British cheque in its current form, the United Kingdom would see its net contribution limited to 0.24% GNI. The negative net balances of the major contributing countries shall be at around 0.6% GNI, with a slightly higher figure for the Netherlands (0.7%) and a slightly lower one for Austria and other old net contributing States (0.5%). All these countries, excepting Belgium, for reasons previously explained, would benefit more from this scenario than that of the Commission. Spain too is equally favored through this hypothesis. Greece, on the other hand, would have a lesser rate of return.

If the generalized cheque mechanism, as envisaged by the Commission (see chapter "The European Budget at the Test of Enlargement"), were to be implemented, all net contributing States would "converge" towards a level of net contribution that lies around 0.47-0.58% of their GNI. The main loser of this system would, unsurprisingly, be the United Kingdom, who shall lose its cheque while at the same time remaining the main net contributor. In sum, the general situation shall improve for all net contributing States in comparison to the Commission's scenario (with the exception of Belgium). Spain remains at a slightly more advantageous position, as opposed to Greece. Moreover, the solidarity effort towards new Member States remains significantly high (3.17% of their GNI).

We finally proceeded to making an estimation in the event of balance ceiling to a reference value of 0.4% GNI. The United Kingdom would lose its cheque, but its final net contribution would be closer to the situation after its cheque (0.24%) than its situation before (0.72%) and

even after a generalized cheque (0.58%). Within this system, Spain, Ireland and even Portugal would become net contributors. The general solidarity effort would fall, also in favor of new Member States (2.61% of their GNI, as opposed to 2.96% in the Commission's scenario with a balance ceiling of 0.5% GNI). The "cost of enlargement" would then be reduced to 23 billion Euros (60 Euros per person per year for old Member States).

In sum, it could be stated that this conservative scenario only slightly limits the solidarity effort required from the major net contributing States (around 0.05% of their GNI for France and Germany in relation to the Commission's scenario). Nor does this scenario prevent a significant degradation of net balances in comparison to 2002 (especially for France and Italy, who bear the main burden of the "British cheque", thereby decreasing their balance by 0.3% of their GNI). The generalized corrective mechanism would represent such a "budgetary shock" for the United Kingdom (-0.3% of its GNI in relation to 2002) that this mechanism would seem a rather unrealistic outcome in the negotiation. The solution that would ceil negative net balances could indeed be the most viable solution in the quest for reconciling solidarity and equity, but this would weigh upon the poorest States of the EU and would pose a problem of principles.

The greatest disadvantage in this conservative scenario is also that it does not sufficiently re-orient the European budget either towards new competitive policies or towards the creation of "European public goods".

Table 2. Conservative Scenario – Simulation of Net Balances in 2013
(2004 prices)

	Balance before correction		Balance after British correction		Balance after generalized cheque		Ceiled balance	
	Million €	% of GNP	Million €	% of GNP	Million €	% of GNP	Million €	% of GNP
Germany	-15,526	-0.59	-16,185	-0.61	-14,113	-0.53	-10,597	-0.40
UK	-15,349	-0.72	-5,116	-0.24	-12,337	-0.58	-8,561	-0.40
Italy	-7,421	-0.46	-9,717	-0.60	-7,899	-0.49	-6,432	-0.40
Netherlands	-3,842	-0.68	-3,982	-0.70	-3,193	-0.56	-2,268	-0.40
France	-8,131	-0.42	-10,890	-0.56	-9,228	-0.48	-7,728	-0.40
Sweden	-1,897	-0.61	-1,975	-0.63	-1,686	-0.54	-1,249	-0.40
Ireland	442	0.32	244	0.18	252	0.18	-524	-0.38
Portugal	933	0.58	702	0.43	711	0.44	-194	-0.12
Greece	3,713	2.14	3,465	2.00	3,475	2.00	2,505	1.44
Spain	3,990	0.46	2,751	0.32	2,799	0.32	-2,049	-0.24
Austria	-1,213	-0.46	-1,279	-0.48	-1,302	-0.49	-1,064	-0.40
Other old members (4)	-2,932	-0.39	-4,006	-0.53	-3,514	-0.47	-3,008	-0.40
New members (12)	28,788	3.31	27,544	3.16	27,592	3.17	22,727	2.61
Total	*-18,444*		*-18,444*		*-18,444*		*-18,444*	

2. “Competitiveness-Solidarity” Scenario

As in the preceding scenario, the “competitiveness-solidarity” scenario limits the EU’s budget to 1% GNI in 2013 (124.4 billion Euros), but its expenditure is allocated in a manner different to that foreseen in the conservative scenario.

2.1. Allocation of Expenditure

Competitiveness expenditure (research, trans-European networks, education, etc.) has been fixed at a similar level to that foreseen in the Commission’s scenario for 2013 (*i.e.* slightly more than 16% of the total budget). Presented with a budget of 124.4 billion Euros in credit payments, this would amount to 20.28 billion Euros (3 billion Euros less than the Commission’s scenario).

In order to enable such a deployment, the sum allocated to regional policy faces a reduction of 20% (37 billion Euros instead of 46 billion in the Commission’s scenario). As desired by several major net contributors, it is uniquely centered on the poorest Member States. Objective 2 is thus eliminated. It would also have been possible to eliminate objective 1.a targeted at old Member States (to compensate for the statistic effect), but the credits of objective 1.a represent less than 10% of objective 1’s total envelope and must be paid in a degressive manner throughout the period 2007-2013.

In this scenario, objective 1 captures 95% of regional policy credit, a residual objective having been preserved for trans-border cooperation programs. The same allocation procedure as that used in the evaluation of the Commission’s scenario has been used for these two objectives: new Member States receive 65% of the expenses of objective 1 and 52% of the expenses of the residual objective. As in the Commission’s scenario, we have made use of the year 2001 to distribute the expenses between old Member States (objective 1 and “EU initiatives”).

Agricultural expenditure is also decreased. Given that the ceiling for direct payments and market intervention has been “sanctuarized”, we observe a 25% decrease in expenditure for rural development. The distribution of this expenditure follows in the lines of the Commission’s scenario.

Non-distributed expenditure remains at a level similar to that observed in the conservative scenario (18.4 billion Euros) and would enable the financing of administrative expenditure as well as external aid expenditure.

The major implication of this scenario is undoubtedly the *quasi total elimination of regional policy within the old Member States* (with the exception of certain zones that still qualify for objective 1, or those who benefit from transitional aid in the name of a European "phasing out" campaign). As in the conservative scenario, the new Member States will receive 30% of the credits by 2013: indeed, the increase in competitive expenditure going towards old Member States compensates for the decrease in regional policy. There hence is no modification of the "enlargement cost" in this scenario (which remains at 75 Euros per person per year for old Member States).

Table 3. Competitiveness-Solidarity Scenario
Distribution of Income and Operational Expenditure in 2013
(payment credits, 2004 prices)

	Income		Competitive expenditure		Cohesion expenditure		Direct agricultural expenditure		Rural development expenditure	
	%	Million €	%	Million €	%	Million €	%	Million €	%	Million €
Germany	21.30	26,493	13.86	2,810	5.88	2,176	11.28	4,308	8.56	899
UK	17.21	21,403	13.86	2,810	0.70	257	7.68	2,933	4.09	429
Italy	12.93	16,081	10.23	2,075	4.63	1,713	10.32	3,942	7.31	768
Netherlands	4.56	5,669	5.95	1,207	0.05	20	2.16	825	1.08	113
France	15.53	19,321	12.74	2,584	1.08	401	17.76	6,784	9.28	975
Sweden	2.51	3,124	2.98	604	0.05	20	1.52	581	0.78	82
Ireland	1.12	1,388	1.58	321	0.71	264	3.04	1,161	1.87	196
Portugal	1.30	1,620	1.67	339	3.59	1,328	1.68	642	2.66	279
Greece	1.40	1,735	3.26	660	6.39	2,364	5.04	1,925	5.83	612
Spain	6.98	8,677	5.67	1,150	12.23	4,524	11.92	4,553	12.12	1,273
Austria	2.14	2,661	2.51	509	0.11	41	2.00	764	1.04	109
Other old members (4)	6.05	7,520	18.69	3,791	0.22	82	5.60	2,139	2.89	303
New members (12)	7.00	8,708	7.00	1,420	64.35	23,810	20.00	7,639	42.50	4,463
Total	*100.00*	*124,400*	*100.00*	*20,280*	*100.00*	*37,000*	*100.00*	*38,196*	*100.00*	*10,500*

2.2. Analysis of Net Balances

The competitiveness-solidarity scenario does not fundamentally modify net balances before correction. These net balances remain at a level similar to the conservative scenario. The United Kingdom, Netherlands, Sweden and indeed Belgium (included in the category "other Member States") would see their situation improve. Germany, Italy, France and Austria would experience minor losses. Amongst the net beneficiaries, new Member States remain at a very high level (3.29% of their GNI). Ireland, Portugal and Greece would see an

improvement in their situation; Spain, on the other hand, would experience slight loss due to a decrease in cohesion and rural development expenditure.

In the application of the British cheque, we find the same result as seen in the conservative scenario as well as in the Commission's proposal: the United Kingdom would become the smallest net contributor (0.23% of its GNI); other net contributors oscillate around 0.6% (with the exception of Austria and Belgium); new Member States remain highly assisted (up to 3.15% of their GNI) while the old "cohesion countries" remain net beneficiaries (especially Greece).

Even in the event of a generalized cheque, as envisaged by the Commission, the balances would be extremely similar to the conservative scenario (excepting Belgium), with a slight shrinking of the solidarity effort in relation to the Commission's scenario.

Finally, the balance ceiling mechanism set at 0.4% GNI also gives out results similar to the conservative scenario. Given that the major focus of regional policies has been the poorest countries, new Member States and Greece see their situation improve slightly, Spain being the biggest contributor.

It could thus be concluded that this scenario, while fixing new priorities (increasing competitive expenditure at the cost of regional policies in old Member States) barely modifies balances in relation to the conservative scenario, with the exception of Belgium and, to a lesser extent, Spain. Belgium's situation could be explained through its high rate of return on internal policy. Spain's situation, meanwhile, could be explained by its high rate of return on structural policies.

In sum, this scenario reconciles budgetary rigor, the priority given to expenditure preparing for Europe's future, and the required solidarity towards States that have been backward in their development. Its major disadvantage, however, is the renationalization, to a large extent, of regional policy, thereby weakening both European legitimacy in this policy (reduced to a mere policy of redistribution towards the poorest States) and the link which exists today between "Europe" and the rest of the European regions. The other disadvantage of this scenario (as in the preceding one) is that it does not sufficiently deal with the problem of "net balances".

Table 4. "Competitiveness-Solidarity" Scenario – Simulation of Net Balances in 2013
(2004 prices)

	Balance before correction		British correction (1999)		Generalized cheque		Balance ceiling	
	Million €	GNP %	Million €	% of GNP	Million €	% of GNP	Million €	% of GNP
Germany	-16,300	-0.62	-16,941	-0.64	-14,365	-0.54	-10,597	-0.40
UK	-14,973	-0.70	-4,991	-0.23	-12,207	-0.57	-8,561	-0.40
Italy	-7,584	-0.47	-9,824	-0.61	-7,949	-0.49	-6,432	-0.40
Netherlands	-3,504	-0.62	-3,641	-0.64	-3,079	-0.54	-2,268	-0.40
France	-8,577	-0.44	-11,269	-0.58	-9,373	-0.49	-7,728	-0.40
Sweden	-1,838	-0.59	-1,913	-0.61	-1,666	-0.53	-1,249	-0.40
Ireland	554	0.40	360	0.26	363	0.26	-344	-0.25
Portugal	969	0.60	743	0.46	747	0.46	-78	-0.05
Greece	3,826	2.20	3,584	2.07	3,588	2.07	2,704	1.56
Spain	2,823	0.33	1,614	0.19	1,633	0.19	-2,788	-0.32
Austria	-1,239	-0.47	-1,303	-0.49	-1,310	-0.49	-1,064	-0.40
Other old members (4)	-1,205	-0.16	-2,253	-0.30	-2,236	-0.30	-3,008	-0.40
New members (12)	28,623	3.29	27,410	3.15	27,429	3.15	22,991	2.64
Total	*-18,424*		*-18,425*		*-18,424*		*-18,424*	

3. "European Public Goods" Scenario

The "European public goods" scenario moves away from the 1% GNI budgetary constraint and takes on the Commission's objective of 1.15% (in payment credits). It attempts, by playing on budgetary masses, to modify the question of net contributions and to develop "European public goods". This scenario could eventually be paired up with the prospects of a political deepening of European construction.

3.1. Distribution of Expenditure

This scenario takes the same budgetary masses as the "competitiveness-solidarity" scenario, but uses the 0.15% GNI supplementary margin to create a "defense fund". The other fundamental difference is that regional policy, in spite of more limited means, is not solely restricted to assisting the poorest States in the EU.

Competitive expenditure thus represents 14% of the budget (as opposed to 16% in the Commission's scenario), more than twice the amount when compared to 2006.

Cohesion expenditure is reduced by 20% in relation to the Commission's proposals. A broad regional policy is nevertheless preserved. This policy includes assistance to the EU's poorest regions and countries (objective 1), assistance to other regions (objective 2), and trans-

border programs (objective 3). The key for the distribution of this scaled-down envelope is the same as the Commission's scenario as well as the conservative scenario. The 20% reduction of the envelope attributed to regional policy is thus distributed to all Member States, including the new.

Agricultural expenditure is distributed as in the "competitiveness-solidarity" scenario. This also implies that rural development expenditure has been reduced by 25%.

Non-distributed expenditure remains at 15% of the budget (*i.e.* 21.5 billion Euros, as in the Commission's proposal). Non-distributed expenditure thus has a bigger envelope here than in the two other scenarios for policies related to freedom, an area of security and justice, as well as for the EU's external policies and administration.

Finally, a "defense fund" has been created. The driving for behind this fund, which could mainly be managed by the recently created European Defense Agency, would be to "co-finance" military and armament research projects as well as external operations (refer Cardot's chapter entitled "Towards a European Budget Dedicated to Security and Defense"). This envelope has a significantly important absolute value (more than 15 billion Euros, as much as what the Commission has foreseen for the "EU as a global actor" sector), but nonetheless has a weak relative value (0.12% GNI, a figure that could be added or removed from national defense budgets).

The starting point of this principle is that the defense fund's expenses, based on the principle of co-financing or "additionality", shall be borne by the States according to their share in the EU's total military expenditure. The key of return that has been fixed is based upon Member States' military expenditure for the year 2002, as published by the *Military Balance*. Some corrections have nevertheless been added. The military nuclear equipment expenditure of France and the United Kingdom, considered as purely national, has been deducted. Police and pension expenditure that inflate the French budget, together with expenses for Italian police officers have also been deducted.

Even after these corrections, France and the United Kingdom would remain, because of the importance of their defense effort, the main beneficiaries of the "defense fund". Germany would also be an important beneficiary, but its rate of return would be slightly inferior to its rate of contribution to the budget as long as it does not increase its defense effort.

The creation of a "defense fund" does indeed have several advantages. It encourages Member States, through the co-financing principle, to consecrate more resources to defense, thereby becoming an important factor in the assertion of the EU in the international arena. It also permits considerable acceleration in favor of the integration of European methods of defense and thus the development of a common tool (armaments programs, joint research projects, etc.). The defense fund also increases the solidarity that links Member States together in military matters, and encourages the opening "decompartmentalization" of military-industrial apparatus. Finally, it improves the net balance situation of the major contributing countries.

The consequence of this scenario is that it mainly reduces the solidarity effort towards new Member States: these States shall receive 23.5% of the total expenditure, as opposed to 27% in the Commission's proposal and 30% in the two preceding scenarios. The "enlargement cost" is thus slightly diminished (slightly more than 60 Euros per person per year for old Member States, before correction).

Table 5. « European Public Goods » Scenario
Distribution of Income and Operational Expenditure in 2013
(payment credits, 2004 prices)

	Income		Competitive expenditure		Cohesion expenditure		Agricultural expenditure		Defense expenditure	
	%	Million €	%	Million €	%	Million €	%	Million €	%	Million €
Germany	21.30	30,476	13.86	2,810	9.40	3,478	10.69	5,207	19.20	2,995
UK	17.21	24,620	13.86	2,810	2.90	1,073	6.90	3,362	20.30	3,167
Italy	12.93	18,499	10.23	2,075	6.20	2,294	9.67	4,710	12.60	1,966
Netherlands	4.56	6,521	5.95	1,207	0.70	259	1.93	938	4.45	694
France	15.53	22,225	12.74	2,584	4.40	1,628	15.93	7,759	18.80	2,933
Sweden	2.51	3,593	2.98	604	0.60	222	1.36	663	2.40	374
Ireland	1.12	1,597	1.58	321	0.60	222	2.79	1,357	0.40	62
Portugal	1.30	1,863	1.67	339	3.10	1,147	1.89	921	1.80	281
Greece	1.40	1,996	3.26	660	5.40	1,998	5.21	2,537	3.75	585
Spain	6.98	9,981	5.67	1,150	13.20	4,884	11.96	5,826	5.00	780
Austria	2.14	3,061	2.51	509	0.70	259	1.79	873	1.00	156
Other old members (4)	6.05	8,650	18.69	3,791	0.80	296	5.01	2,442	5.00	780
New members (12)	7.00	10,017	7.00	1,420	52.00	19,240	24.85	12,102	5.30	827
Total	100.00	143,100	100.00	20,280	100.00	37,000	100.00	48,697	100.00	15,600

3.2. Analysis of Net Balances

Prior to correction, negative net balances shall remain important for the major net contributors, but they are by large less unfavorable than in the Commission's proposals. Only the United Kingdom would exceed the 0.6% GNI limit. New Member States obtain relatively less aid: 2.71% of their GNI as opposed to 3.3% in the other scenarios.

It is interesting to calculate the real impact of this scenario on each Member State's public finances. If expenditure for the defense fund were to proportionately decrease national defense budgets, real consolidated net balances would then be limited to 0.4% to 0.5% GNI for the main contributing countries (with the exception of Italy, France and Belgium who would be in a more advantageous situation). The budgetary solidarity effort would remain significant for new Member States and even for Greece and other old cohesion States.

It is also important to specify that the calculation of "real consolidated" net balances should also take other factors into account. The reduction of national defense budgets should not be automatic: on the contrary, the establishment of a "defense fund" should help increase the overall defense effort of the European Union. Next, changes in other common policies (internal, agricultural and regional policies) could similarly lead to changes in the national budget's burden-sharing (charge).

If one were to accept the principle that European defense expenditure shall be deducted from national budgets, the United Kingdom would then find itself in an advantageous situation, with a real consolidated balance (0.52%) that is half way between its net contribution in the Commission's proposal (0.77%) and the application of its cheque (0.26%). The United Kingdom is better off here than when the generalized cheque mechanism is applied to the Commission's scenario. Germany would be in a similar situation as the United Kingdom, far more advantageous than the Commission's proposal (0.49% instead of 0.66%). France and Italy, meanwhile, would be in an even more advantageous situation (0.34% for Italy; 0.23% for France who gains much from the defense fund). New member countries would receive approximately 2.85% of their GNI as aid if they were to reduce their defense budgets according to their return from the defense fund.

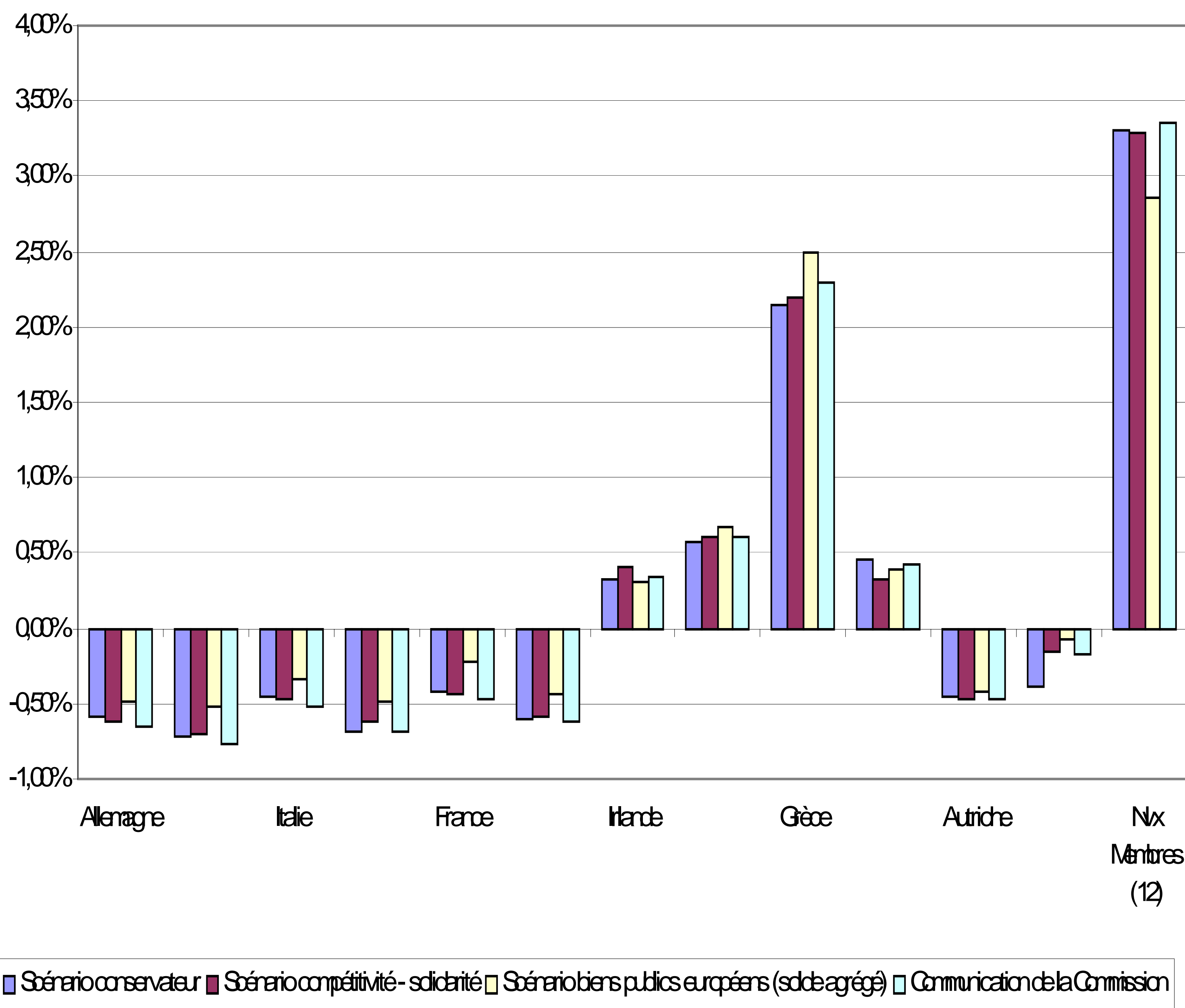
This last scenario is certainly not the least promising, although it is not the most realistic. It attempts to find a (rather imperfect) solution to the problem of net contributions, and it simultaneously encourages the significant development of a "European public good"-defense. It gives clear priority to growth-enhancing policies, and at the same time preserves

common policies of the past (agricultural and regional policies). It encourages strong solidarity towards the EU's poorest States, without however permitting this effort of solidarity to cost price of a generalization of the British cheque.

Table 6. "European Public Goods" Scenario – Simulation of Net Balances in 2013
(2004 prices)

	Net balances before correction		Consolidated net balances, real impact on public finances	
	Million €	% of GNI	Million €	% of GNI
Germany	-15,986	-0.60%	-12,991	-0.49%
UK	-14,208	-0.66%	-11,041	-0.52%
Italy	-7,454	-0.46%	-5,488	-0.34%
Netherlands	-3,423	-0.60%	-2,729	-0.48%
France	-7,321	-0.38%	-4,388	-0.23%
Sweden	-1,730	-0,55%	-1,356	-0.44%
Ireland	365	0.26%	427	0.30%
Portugal	825	0.51%	1,106	0.68%
Greece	3,784	2.18%	4,369	2.50%
Spain	2,659	0.31%	3,439	0.39%
Austria	-1,264	-0.47%	-1,108	-0.42%
Other old members (4)	-1,341	-0.18%	-561	-0.08%
New members (12)	23,571	2.71%	24,398	2.85%
Total	*-21,523*			

Graph 1. Comparison of Net Balances Before Correction in the Different Scenarios



4. Conclusions

These scenarios are not the only possible scenarios. One could imagine, for example, a certain variation of the "European public goods" scenario where the credits of regional policy would be focused on the poorest countries (as in the "competitiveness-solidarity" scenario), or still more, a variation where the European budget would be brought to 1.3% GNI of the payment credits, by adding the defense fund to the Commission's scenario. In all these

variations, however, the negative net balances of all the main net contributors would be greater.

These simulations should above all enable us to certain draw conclusions.

The first question to be dealt with is that of *policy choices* that ought to inspire common policy. The European Union cannot at the same time maintain budgetary rigor in its expenses, preserve agricultural policy, maintain a regional policy that benefits all Member States, increase expenses that favor the competitiveness of the European economy, and develop a "European public good"-defense. Priorities should then be laid down since the level of ambition cannot be the same in all fields.

The second question deals with the *correction of net balances*. The enlargement of the European Union towards poorer countries results in increased disparities between three groups of countries: "rich" countries who are called upon to be major net contributors; "poor" countries who require much aid; and countries in an "intermediary" situation (Portugal and Spain). This situation poses the question of financial equity of the European budget in a new angle. Taken in its current form, and given the extremely high budgetary deviation of enlargement, the British cheque becomes a completely unjust system. It should either be reduced, or replaced by a generalized corrective mechanism. Simulations clearly indicate that net balance variations are not highly different from one scenario to another, except in the radical hypothesis of a pure and simple ceiling of net balances beyond a certain limit (0.4% or 0.5% GNI).

Although a generalized corrective mechanism, and *a fortiori* ceiling of net balances would seem to offer a solution to the problem of net balances (on the condition that the United Kingdom accepts to lose its cheque), they are wholly in contradiction with the spirit of European solidarity. They blur the political legibility of the European budget. They even run the risk of rendering Member States, particularly the major net contributors, less responsible and little or not interested managing expenditure. They finally pose methodological problems regarding the calculation of net balances, even though Member State's interests should not be reduced to the mere measurement of net balances.

It is hence important to find another means of making differences in net balances more relative, if one is to avoid such deviation. The common agricultural policy is largely responsible for differences between contributing countries. The greater the reduction of its importance, the smaller the distortion would be. The main aim of regional policy is to assist

the poorest countries, but it is symbolically important that this regional policy also brings certain advantages to the richer countries. Internal policies could offer further advantages to the main contributing countries, if these policies were to be based on policy decisions (for example, the creation of research centers in Germany and the United Kingdom, or the more significant development of trans-European networks in these two countries). The budgetary development of a common European defense policy is another encouraging prospect: here finally is a common policy that would be of advantage to the United Kingdom as well as Germany, if the latter accepts to slightly increase its defense effort.

One should however guard against having too many illusions about the possibility of developing a European federation with corresponding budgetary means. Nevertheless, an evolution enabling the development of "European public goods" and which could revive financial solidarity by breaking the logic of just return, would no doubt be useful in helping Europe advance. Europe would advance still further if the European public good in question would help strengthen the legitimacy of European construction in the eyes of its citizens, and also permit the useful completion of Member States' actions. We could then imagine the setting up of a European tax and the strengthening of European political integration.