

Reshaping the EU Budget: Yet Another Missed Opportunity

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'National and Supranational Economic Policy to Correct Internal
Disequilibrium Under EMU'

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*A study of the evolving policy strategies in a range of countries to secure
adjustment to internal economic disequilibrium under EMU.*

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1 Introduction

In the early morning of the 26th of March 1999, the EU's heads of state and of government emerged from a marathon meeting to unveil the *Financial Perspective* for the period 2000-06. Six weeks later, the deal was formally approved by the European Parliament by a two-to-one majority. The outcome should, therefore, be that the EU's finances are secure for the next seven years. That a deal was reached may, at first sight, seem surprising, as the auguries were not good when Germany took over the Presidency at the beginning of the year. Perhaps paradoxically, the débacle of the resignation of the Commission and the ensuing soul-searching about the future of the Union may have helped, as Europe's leaders felt obliged to try to rebuild confidence. The start that week of the bombing campaign against Yugoslavia was probably also significant, as a continuing squabble over relatively tiny sums of money would have looked petty.

Yet although the importance of securing a deal should not be under-estimated - failure would have risked plunging the EU into financial crisis within a few months - the agreement ducks most of the major questions about the role and character of the EU budget. Moreover, many specific elements in the package are backward steps that are likely to lead to more intractable problems in future. Even though there is provision within the Budget for a steady growth of expenditure on the Central and Eastern European countries (CEECs), both before and after accession, there must also be suspicions that the new *Financial Perspective* will delay rather than facilitate enlargement.

This paper appraises the 2000-06 *Financial Perspective* as now agreed and examines its shortcomings in relation to the development of the EU. The next section considers the question of why there is an EU budget and points to the confusion in aims ascribed to it. The background to the new agreement is then described and appraised. In the concluding sections of the paper, the focus is on what might have been and possible ways forward.

2 Why have the EU budget?

Unlike most other supranational organisations, the EU has had specific policy tasks assigned to it from the Member States. However, as Wessels (1997) points out, the division of competences in the EU is not along the neat lines of a federal system, but is 'a messy and ambiguous division of labour between national and EU levels'. While the bulk

of its resources is hypothecated to the core competencies of the union, it is by no means obvious what the EU budget is for. It is, as Laffan (1997: p15) puts it: 'at the borderline between politics and economics, between market integration and political union, wider economic integration and political union'. It has long proved to be a contentious policy area¹, yet it is far from clear what its fundamental purpose is - if, indeed, one can be discerned.

Plainly, the formal justification for the budget is to fund common policies. From the early days of the common market, agricultural support has been a mainstay of supranational policy, necessitating a flow of resources. Similarly, as cohesion became a more important priority, the sums allocated to the Structural Funds increased progressively to reach their current level of about a third of the budget. The logic of common policies dictates that they need to be funded appropriately and the rationale for the budget also demands that Member States display a commitment to them that, given the ambivalence about, notably, the CAP, is not always evident.

Common policies have the additional property that, once a policy is agreed, it cannot easily be administered to ensure that each Member State obtains a 'fair' share unless the policy itself is so distorted that its underlying purpose is traduced. Thus, to the extent that a plausible case can be made for the CAP (even though many might consider this intrinsically impossible), it should be designed to fulfil aims such as assurance of food supply or preservation of rural economies. Even then, a policy which has aims that cannot be reconciled is open to abuse. With cohesion (itself a term open to multiple interpretations - see Begg and Mayes, 1991), the aim of policy is to diminish regional and social disparities. This should imply concentration of policy action on the least-favoured, yet all Member States benefit to some extent from the Structural Funds.

A second rationale for the EU budget would be to balance gains and losses from European integration. The establishment of the common market and its evolution from single market to economic and monetary union cannot be expected to benefit all participants equally. To the extent that some gain more than others, it can be argued that the 'winners' should pay and 'losers' receive. Some of the broad bargains that have been struck at European level reflect this philosophy. Thus, for the Germans, market access

¹ See Wallace (1980), Nicoll (1988) and Shackleton (1990).

and political integration are prizes that make a substantial net contribution to the budget worth paying. The net flows of money under the EU budget can be seen in this context as a fair price to pay for non-fiscal benefits.

The Commission, in particular, has long emphasised that Member States should look at the wider benefits. In a paper produced in 1998, it argued that:

‘Budgetary flows do not capture all the benefits from membership in the EU. EU membership, which gives rise to financial and non-financial advantages as well as obligations, has a non-budgetary dimension the importance of which dwarfs the budgetary one. For example, the benefits from the pursuit of common objectives, such as trade liberalisation and European economic integration, cannot be evaluated in terms of budgetary flows alone. Moreover, flows from the EU budget invariably benefit not only recipients but other Member States in the form of return flows; typical examples are structural funds and external expenditure, where the implementation of projects often gives rise to purchases of goods and services from other Member States.’ (European Commission, 1998b)

Gretschmann (1998) has developed a related argument in some work for the European Parliament. His contention is that the fiscal effects of EU membership greatly outweigh the direct net contributions to the EU budget and that Member States should, accordingly, take a more extensive view of the cost to them of membership. Gretschmann focuses in particular on the trade gains that countries enjoy and calculates that this yields additional tax revenues that, in some cases, are several times as big as the actual payment to the EU budget. His methodology is to compute how much the exports of a country switch towards the EU as a result of accession. This trade gain is then multiplied by the tax rate to give the additional tax yield attributable to EU membership. A country that sees a large re-orientation from exports to third countries to exports to the EU has the biggest gains.

The outcome of Gretschmann’s calculations is a somewhat counter-intuitive one which shows the largest relative gains being made by Ireland, Denmark and the UK, whereas German gains from EU integration are modest. Two of the new entrants, Sweden and Austria, lose from integration. The reason for this is that the approach adopted by

Gretschmann is unbalanced because he uses shifts in exports inappropriately as a proxy for the benefits from EU integration. This methodology is open to the very strong criticism that it ignores the corresponding switch in import patterns, which will tend to have an equal and opposite impact on tax revenues. In any case, it is shifts in GDP caused by EU membership which should be assessed, not trade changes. Some of the assumptions underlying the calculations and the data used are also open to question, so that what appear to be compelling results have to be discounted.

Cohesion is the third reason for an EU budget. It also implies net payments, although the criterion in this instance is relative prosperity rather than whether or not the Member State gains relatively from EU integration. In most nation-states, fiscal transfers redistribute from rich to poor areas or from wealthy to badly-off social groups. In the EU setting, this redistribution occurs in a somewhat indirect manner. Resources flow to rural areas through the CAP, but although two 'cohesion' countries - Greece and Ireland - gain substantially from the CAP, the targeting is very imprecise. The Structural Funds are explicitly designed to advance cohesion, but they do so principally by bolstering public investment, widely defined. The target here is the growth rate of assisted regions or the reintegration of marginalised social groups. Through this kind of support *future*, rather than current incomes should be advanced. The contrast between this approach and the solidarity mechanisms that most countries have is worth noting. German monetary union, for instance, involved massive transfers from West to East to sustain *current* incomes in the new Länder. Although it is probably correct to say that transfers under the Structural Funds often slide into current incomes, the difference in philosophy remains.

The fourth way of looking at the EU budget is that it constitutes a club subscription for which the members of the club expect to obtain services. Just as members of a tennis club expect to obtain a fair share of time on court in return for their club subscription, many EU Member States look for a *juste retour* from the budget. A fair return need not mean a precisely equal return, but there is an expectation that the imbalance in net receipts or contributions should not be too great.

3 Background

The EU budget has changed significantly as the Union itself has evolved from the original customs union to a fully-fledged, if still incomplete, economic and monetary union. In the early days of the then EEC, most of the expenditure went on the common agricultural policy (CAP). Successive enlargements of the Union and the gradual 'deepening' of economic integration have seen more tasks assigned to the supranational level and a steady increase in the size of the budget. In particular, the creation of the European Regional Development Fund and the greater emphasis given to 'cohesion' as an objective since the mid-1980s resulted in rapid growth in spending on what is now known as 'structural operations'.

The financing of the budget has also evolved considerably as it has expanded. Originally, it was financed by grants from the Member States, but the aim was always to give the Union its own resources - taxes that 'belonged' directly to it and which did not depend on decisions by national finance ministers. In 1970, the proceeds of agricultural levies on products imported from the rest of the world and customs duties charged on imports were assigned to the Union, though Member States continued to collect them and to retain 10% of the proceeds for this task. Because these two resources proved insufficient, a proportion of national VAT receipts (on a supposedly harmonised base) was then added as a third resource in 1979. A more flexible fourth resource was added in 1988, based on GNP. Since then efforts have been made to identify other potential tax instruments, but without conspicuous success (Begg and Grimwade, 1998; Gretschnann, 1998).

With most of the expenditure going on the CAP, the UK (with a relatively small agricultural sector) received a very low share of Union spending, an outcome that caused increasingly fractious disputes in the early 1980s. The matter was eventually settled in 1984 when an abatement of the UK's net contribution was agreed. The deal was that two-thirds of the net contribution of the UK (i.e. the difference between its gross contribution and the gross EU expenditure in the UK) would be abated, subject to some technical adjustments. An important property of this arrangement is that if the amount of spending in the UK from EU policies goes up or down, two-thirds of the change will be offset in the abatement. Some commentators argue that this creates unfortunate incentives.

Since 1988, the EU budget has been set in a medium-term financial framework known as the *Financial Perspective*, the first of which ran from 1988-92. This sets out a multi-annual programme of spending according to broad headings of expenditure. The 1988 agreement also set a cap on the size of the budget, limiting it to 1.2% of GDP by the end of the 1998-92 period. A new *Financial Perspective* was agreed at the Edinburgh European Council in 1992, this time to last for seven years, with the spending limit set to rise to 1.27% of GDP, although in recent years the annual budgets have stayed some 10% below the permitted ceiling. The outcome of the March 1999 Berlin European Council was agreement on spending plans for the period 2000-06.

The size of the EU budget is, thus, much more modest than might be inferred from the very heated negotiations that surround it. From very low levels at the beginning of the Community, it had grown to 1.15% of EU GDP by 1998 (Table 1).

Table 1 The EU Budget, 1960-1998

	1960	1965	1970	1975	1980	1985	1990	1995	1998
Size of budget, ECUs billions (1998 prices)	0.48	2.22	18.40	19.68	34.13	43.09	56.25	73.74	85.66
Budget as % of EU GDP	0.03	0.11	0.74	0.54	0.80	0.93	0.95	1.06	1.15

Source: *The Community Budget: The Facts in Figures* (European Commission, 1998a).

Net contributions

In aggregate, the EU budget has to balance, but national contributions to, and receipts from, it do not. Mrs Thatcher's campaign in the early 1980s was about the inequitable nature of net contributions and other Member States have since also become agitated on this account. As noted above, the Commission, not without reason, argues that the gains from economic integration greatly outweigh the (fairly modest) net financial contributions, with the result that the focus on *juste retour* is unwarranted, although that will not deter net payers from doing the arithmetic.

In any attempt to measure net contributions, there are conceptual problems

associated with the calculation that can give rise to confusion in the statistics, not to mention use of them that bears out Disraeli's well-known dictum. There are methodological problems in assigning both sides of the budget by Member State. Customs duties, for instance, are collected at the point of entry into the Community, with the result that the Netherlands appears to make a very large payment (nearly three times its pro-rata share of GNP) under this heading. The reason for this is that Dutch ports are the main points of entry to the EU from the rest of the world, and this 'Rotterdam' effect means that what appears to be a Dutch contribution is often effectively paid by consumers resident in other Member States. Some items of expenditure cannot, by definition, be allocated by Member State as they are extra-territorial, foreign aid being the prime example. It is an open question whether the money spent on administration should be assigned to the two main recipients, Belgium and Luxembourg, or seen as supranational².

Nevertheless, there are undoubtedly systematic imbalances in net payments into the budget, and it is understandable that these engender strong feelings. It is also plain that net contributions loom prominently in the negotiating tactics of Member States. In particular, Germany and the UK have long been substantial net contributors, although they have been joined, latterly, by several others. Indeed, Germany, the Netherlands Austria and Sweden - now known irreverently in the Commission as the *gang of four* - formally applied for rebates in the run-up to the Berlin Council. The Netherlands, as an illustration, has seen a steady rise in its apparent net contribution, largely as a result of the MacSharry changes in agricultural support implemented in the early 1990s which resulted in a relative decline in support for products which the Dutch grew. Germany is also a special case in that its contribution to the UK rebate was pegged at a lower level than other Member States.

Gross contributions to the budget are reasonably proportional to Member State GNPs, a fact that the Commission welcomes. Perhaps surprisingly, the data show that the UK (after the rebate) pays the least relative to GNP followed by Italy, while the Dutch contribute most. It should, however, be noted that payments do fluctuate from year to year because of exchange rates, changes in consumers' expenditure and trends in imports, and the 'Rotterdam' effect is also relevant.

² As regards household incomes, Luxembourg is especially problematical in that a sizeable proportion of the 'Eurocrats' employed in Luxembourg live in the three neighbouring Member States.

Budget imbalances today arise predominantly on the expenditure side, with spending on both the CAP and structural operations favouring the 'cohesion' countries. The data can be presented in differing ways and this is often a source of confusion, if not outright dissembling. The Germans, not unreasonably, stress the gross flows; Spain draws attention to per capita gains, while the UK likes to emphasise how little it receives compared to a Community average. GDP, population and shares of the budget are all possible denominators for computing comparable ratios. Questions also arise about the use of current as opposed to purchasing power adjusted exchange rates. In short, although the more extreme disparities emerge whatever measure is employed, it is a statistical minefield.

In Figure 1, the 1997 shares of financing and the shares of 'operational expenditure' (which *excludes* the costs of administration) that can be attributed to each Member State are juxtaposed. It can be seen that the German share of payments is double that of receipts. The UK, even after the rebate, is still a net contributor, but less so than Germany and the other three Member States that formally asked for abatements. If equal burden sharing is the test, these five Member States are the most hard done by.

Four Member States (Greece, Ireland, Portugal and Spain) are regarded as the targets of cohesion policy, so that their (substantial) net receipts from the EU budget are justifiable³. The net position of two further Member States, Belgium and Luxembourg, is heavily affected by EU administrative expenditure, 80% of which goes to these two countries. If administrative expenditure is included in the calculation, both are substantial net recipients (the accounting budgetary balance concept), with Luxembourg apparently receiving a net transfer as high as 5% of GNP over the period 1995-97. But if the operational budgetary balance concept is used (as in figure 1), the two countries are net contributors on a par with the UK.

Finland, which has a per capita GNP marginally below that of the UK is a modest net beneficiary from the EU budget, as is Denmark which is the most prosperous Member State after Luxembourg. For the former, it is a combination of a relatively

³ Ireland, however, has grown so spectacularly during the 1990s that the high level of transfers it receives now seems unwarranted, although its GNP remains well below the more frequently quoted GDP.

low gross contribution and slightly above average receipts from the Structural Funds that explains the balance, whereas Denmark continues to benefit disproportionately from the CAP even after the MacSharry reforms. Both France and Italy, the two remaining Member States, are modest net contributors: France because it receives much more from the CAP than its GNP 'share', and Italy because its share of gross contributions is well below its GNP share. The reason for this shortfall is that Italy collects less VAT per unit of GNP than other Member States.

Demands on the budget

The Commission prepared the ground for the Berlin summit by publishing proposals for the next seven years in the summer of 1997, a document known as *Agenda 2000* (EC, 1997). A subsequent document, published in October 1998 (EC, 1998b), set out options for the future financing of the EU, focusing especially on whether there should be changes in how the money to pay for the EU is raised. Although the word 'reform' features prominently in both documents, the reality is that the proposals largely preserve the *status quo*. Various financing options were discussed, but the recommendation was to leave the own resources decision as it was, while on the spending side, both the ceiling for expenditure and the broad mix of outlays were to be continued. The one significant switch proposed was a gradual build-up of spending on the countries of central and Eastern Europe (CEECs), based on the working assumption (probably unrealistic even in 1997, let alone now) that new members would accede from 2002.

In the jousting that preceded the Berlin summit, a whole series of demands surfaced, many of them mutually exclusive. Among these problems, the following are the most significant:

- ❖ Net contributions had, arguably, become too unbalanced. For the net contributors (or donors), the indirect gains - market access, freedom of capital movement, even the political binding together of Europe - must be assumed to outweigh the financial cost. This is the essence of the Commission argument for not focusing on *juste retour*. It can, however, be argued that, because net contributions are the result of unpredictable swings in expenditure on different types of policy, the implicit bargain had tilted too far against the main paymasters.

- ❖ Reform of the CAP is an imperative not just for enlargement, but also to meet the EU's obligations in global trading arrangements. Yet proposals to curb it are always resisted and a suggestion that national co-financing of CAP spending be implemented was, not surprisingly, resisted by net beneficiaries.
- ❖ The financing of the budget has become a hotch-potch which bears little relationship to ability to pay. Some Member States, notably Spain, have called for greater progressivity in gross contributions.
- ❖ The UK rebate is not only resented by other net contributors, but also has perverse incentive properties. But the UK argued that as the fifth poorest Member State, it should not be one of the principal net contributors.
- ❖ The rationale for the Cohesion Fund - set up to help the least well-off countries to maintain public investment while meeting the Maastricht criteria - was called into question, now that three of the four beneficiaries have joined the first wave of EMU.

4 The outcome

The decisions taken in Berlin give something to everyone, but do so in a manner that has more to do with fudging or avoiding hard decisions rather than achieving lasting reform. Principles seem to have been ignored in favour of expediency. The obvious retort is that this is not only how the EU always operates, but is also an inevitable feature of any process of bargaining. Yet while normative criteria may not feature as prominently as dispassionate observers might hope in settling the EU budget, it is worth looking at the how the deal was constructed, if only because the subsequent evolution of the EU will reflect the way it is financed and the expenditure it undertakes.

The principal fudges

The outcome on the CAP is especially unsatisfactory. Proposals to rein in EU spending by co-financing part of agricultural support from national sources were rejected. Two weeks before the summit, the agriculture ministers had agreed to cut some intervention prices, but to compensate farmers for their losses. Berlin actually watered down these reforms, thereby giving France and others an outcome they wanted. By 2006 CAP spending is planned to be about 2% higher in real terms than in 1999. The UK retains its abatement (although because of unanimity, it was never seriously in doubt), while the agreement probably does enough to mollify the major net contributors, but only by storing up future problems.

One of the over-riding political aims of the budget package was to diminish the imbalances in net contributions, particularly amongst the richer Member States that had formally applied for UK-style rebates (Germany, the Netherlands, Austria and Sweden). Three different mechanisms will bring this about:

- ❖ First, the 'gang of four' will, in future, only have to pay 25% of their *ex-ante* share of the UK rebate, thereby displacing their share of the bill on to the other ten Member States. Table 2 shows the effect of this change, based on the projected rebate for 1998 from figures in the Commission's October 1998 Communication. Observers of the Franco-British relationship will immediately spot that French relief at keeping CAP spending largely intact will be offset by irritation at having to pay an increased contribution towards the UK abatement. France will pay an extra Euro 263million per annum, Italy 216 million, while Germany saves 411 million. It is easy to see why Messrs Chirac and Jospin were so tetchy about the continuation of the rebate.

Table 2 Gains and losses from the reassignment of the UK abatement
(million euros per annum, based on 1998 rebate)

Germany	Netherlands Austria Sweden	France	Italy	Spain	Others
+411	+326	-263	-216	-102	-157

Source: author's calculations, based on data in EC (1998b).

- ❖ Second, various 'particular situations' allowed for in the Structural Funds will result in

increased net payments to these countries. Most of the 'particular situations' (see box 1) are, in effect, *ad hoc* exemptions from the rules which opens up the prospect that a plethora of new ones will be brought forward in future. None of these seems to be based on any discernible principle. Thus, 'to take account of the particular characteristics of labour market participation in the Netherlands, an additional amount of 500 million euros are allocated to Objective 3.' Readers may wish to speculate on what these unique Dutch labour market characteristics might be. The Dutch also gain because a total amount of around 550 million euros will be allocated to the Netherlands inside the Community initiatives - a specific component of the Structural Funds. Austria, too, is to benefit from earmarked spending under the Community Initiatives as 'around 350 million euros will be allocated to Austria' For Sweden, 'assistance totalling 150 million euros over the period 2000 to 2006 will be established for Sweden in the framework of Objective 3'; and 'a special programme of assistance totalling 350 million euros will be established for the Swedish NUTS II regions

- ❖ Third, changes in the method of financing the Union (less from traditional own resources and VAT; more from the GNP '4th' resource) will favour them. The first of these changes is that the proceeds from the two traditional own resources will now be subject to a 25% 'collection charge' that will accrue to Member States, instead of the 10% that currently applies. This will reduce the contribution of the two resources to barely 10% of the budget. The Netherlands will obtain a large windfall gain, because of the Rotterdam effect. The UK too would have obtained a windfall gain, but has agreed to forgo it. The second change is a progressive reduction in the VAT resource in two steps from 1 percentage point of the proceeds of VAT to 0.5. Here too there will be minor shifts in the burden of payment, with the UK again agreeing to forgo the anticipated windfall gain.

To make up the difference in EU revenue, the fourth resource will, necessarily, account for a larger share of future revenue. This change will make gross contributions to the budget more directly proportional to GNP, supporting the aim of linking payments to ability to pay, though not ceding grounds to demands for *progressivity*. But it will also mean that the EU is funded predominantly by direct transfers from the Member States rather than by genuine own resources, undermining the financial autonomy of the EU and conflicting with article 201 of the

Treaty. The outcome also means that not only does the anomaly of the UK rebate continue, but also that a further anomaly has been created for the four Member States given a discount on their contributions to the UK rebate.

On the structural and cohesion funds, the European Council had to reconcile demands from net contributors to receive more *and* to pay less. It was agreed that spending in the existing Union should total 213 billion euros in the period 2000 to 2006, below what the Commission had proposed in Agenda 2000, but still affording substantial gains to the four cohesion countries. In spite of attempts to stick to the rules, notably the 75% of GDP threshold for eligibility for Objective 1, the pork-barrel approach can be seen by considering some of the examples. Several regions currently designated as Objective 1 under the Structural Funds will lose that status because they are above the formal eligibility threshold, but have been offered side-payments which preserve their receipts. In other words, regions such as Hainaut and Northern Ireland are being let in by the back-door to Objective 1. Anyone looking at the list can only marvel at the charmed life of the Abruzzi, to the East of Rome, which had continued to receive substantial EU support in previous rounds of the Structural Funds in spite of being above the Objective 1 threshold and is again singled out for special treatment. The phrase used is that 'special attention will be given to areas of the Abruzzi which are adjacent to Objective 1 regions'. One of the perils of late night negotiations without adequate preparation is, however, illustrated by this provision, as it turns out that there are no such areas!⁴ Even the four 'cohesion' countries, all of which have substantial net receipts from the budget receive a backhander in the form of 'a special financial allowance' designed to maintain 'the overall average level of per capita aid reached in 1999. The amounts concerned are 450 million euros for Greece, 450 for Portugal, 40 million for Ireland and 200 million for Spain.'

The Berlin agreement assessed

The fact that a deal was reached at Berlin is by no means unimportant for the EU. Given that the new *Financial Perspective* had to be ratified by the European Parliament, a failure by the European Council, to agree at the end of March could well have had damaging consequences, especially after the confusion precipitated by the Commission's

⁴ I am grateful to Fabio Colasanti for pointing out this curiosity. Pier-Carlo Padoan has, however, informed me that the oversight has since been corrected, so that the Abruzzi will again benefit.

resignation. The whole process could easily have stretched into the Autumn, leading to a freeze on new spending and the prospect of considerable disruption to structural operations co-funded by the budget. Other positive features claimed for the deal are that it paves the way for enlargement, striking a reasonable balance between the demands of the EU-15 and the expectations of the candidate countries, and that it does so without adding to the overall fiscal burden. But it can also be argued that, in concentrating in reaching a deal, the EU leaders have allowed urgency and expediency to over-ride longer term imperatives.

In particular, it is harder than before to see an underlying logic to the budget. The principles have been muddled rather than clarified, with a confusing mix of *juste retour* and funding for common policies underlying the decisions, but little evidence of any strategic view of what the budget should try to do as an instrument of policy. The financing instruments have been revised, ostensibly to achieve greater fairness, but have ended up more anomalous than before. Even the modest reforms of the CAP agreed by the Agriculture Council prior to the Berlin meeting were watered down. Thus, while allowing all concerned to save face, the agreement solves few problems and leaves the future role of budget unclear. Some would argue that it was ever thus, and that expecting such difficult negotiations to yield outcomes that conform to academic models is pie in the sky.⁵ Equally, if an agreement contains too many provisions that detract from its underlying purpose, it will eventually fall into disrepute. The next section explores how the budget might have been re-shaped.

5 Six missed opportunities

With EMU now started and enlargement on the horizon, the 2000-06 *Financial Perspective* could have been the platform for a major rethink of all aspects of the EU budget. That it has not is, perhaps, a prime illustration of Scharpf's 'joint decision-trap' (Scharpf, 1988). Rather than resolving the fundamental weaknesses in the system, the Berlin deal did just enough to mollify each of the participants in the horse-trading. Even if many of the issues considered here have little chance of being adopted, it is, nevertheless, useful to reflect on what might have been. A starting point would have been an unambiguous statement of the principles underlying the budget, its purpose and scope. Plainly, it does not fulfil the role of federal budgets

⁵ Sir William Nicoll and Fritz Scharpf stressed this point in comments on earlier versions of this paper.

elsewhere and cannot play much part in either stabilisation or redistribution policy, nor will it do so in future.

What could have been made clear was that the provisions in the *Treaty* were to be followed and that the aim of EU spending was to advance common policies, not to ensure *juste retour* - however naive that might sound. Beyond that, the opportunity was also missed to map out the future responsibility of the EU level generally, and the budget in particular, in the economic management of the Union. The figure of 1.27 (the ceiling for financing as a percentage of EU GDP) has acquired near mystical significance, yet it has no economic rationale. Rather than deciding what tasks it makes sense for the EU to fulfil and assigning resources accordingly, the primary aim of Europe's leaders seems to have been to enforce the 1.27% limit, thereby ruling out any transfer of competence to the Community level in economic policy areas requiring public spending. Nor does it sit easily with the need to review Union commitments beyond the traditional areas in the first pillar. Monar (1997), for instance, is critical of the lack of thought that has gone into the funding of third pillar activities and the vagueness of funding for the CFSP is likely to be similarly unsatisfactory, especially post-Kosovo. Indeed, the EU's capacity to take on wider tasks - whether in areas such as peace-keeping or reconstruction of war damage - will be hampered by the absence of suitable funding.

The second broad area of criticism concerns the position of the budget in relation to EMU. Much has been made in the analysis of EMU of the lack of a fiscal counterpart to the ECB, the absence of automatic fiscal stabilisers and a lack of structural homogeneity (Feldstein, 1997; Bayoumi and Masson, 1995). It would be far-fetched to believe that a fully-fledged 'federal' budget with the express purpose of countering some of these deficiencies could evolve given the mistrust in, and weakness of, the EU level. But without going that far it is plain that some shifts might be warranted (see, for example, Spahn, 1993a and 1993b). The complete absence of *any* apparent willingness to explore the role of the budget in economic governance is, therefore, profoundly disturbing.

Enduring reform of the financing system is widely agreed to be necessary, yet equally widely agreed to be problematic. The Commission, in preparing the ground, effectively gave up any attempt to lead by opting not to advocate change and simply setting out options that might help to diminish excessive net contributions. The hotch-potch of financing instruments has been retained, but re-weighted and although it yields an

outcome today that all the Member States find acceptable, it will not take much for this consensus to unravel. The lack of an easily identifiable fifth (or further) resource and of mechanisms for equalisation are reasons put forward for inaction, but they are not convincing. The problem is not in identifying new resources (see Smith, 1992; Begg and Grimwade, 1998; Gretschnann, 1998), but in the political will to pursue change. Moreover, the reluctance on the part of Member States to budge on giving the Union genuine own resources, even though they have all signed up to Article 201 of the *Treaty*, shows that financial autonomy for the supranational level is still a remote possibility.

A fourth missed opportunity is that, once again, meaningful change in the CAP has been ducked in favour of tinkering with the basic system. The MacSharry reforms of the early 1990s together with the present changes have, undoubtedly, had a sizeable impact on the distributions of costs and benefits from the CAP and have achieved some shifts towards income support. But too much of the basic structure remains and this simply stores up problems linked to enlargement and to the EU's obligations under the international trading system. The banana war will seem like a playground fight when the real battles over agricultural subsidies start.

On the face of it, the Agenda 2000 package offered a viable route to enlargement and the Berlin agreement broadly accepts the Commission proposals. Spending will build up gradually beyond the assumed accession date of 2002⁶, to reach a quarter of a percentage point of EU GDP. Moreover, by 'ring-fencing' the money for enlargement, the proposals ensure that so far as existing solidarity mechanisms are concerned, there is sufficient scope to accommodate new members without cutting back unduly on outlays in EU15. That is the creditable part of the package. Where it falls down, however, is in failing to adopt wider reforms that would recast the role of the EU and modernise its policies. The equivocation over the CAP is, again, an issue here, as it is recognised that the large share of agriculture in the CEECs implies continuing upward pressure on spending on an unreformed CAP. Thus, although the package appears to offer enough for the CEECs, there must be a suspicion that other aspects of the deal are likely to delay enlargement. The missed opportunity to reform the budget may well have put the timing of enlargement in jeopardy.

⁶ This date is purely for financial planning purposes, rather than being a prediction of when accession will actually occur. If there is a delay, the money will simply be returned to the Member States.

As noted above, imbalances in net contributions had become a major concern. By adopting various devices to attenuate these imbalances, the EU's leaders have, arguably, resolved the problem for the foreseeable future. Yet it is hard to believe that the series of *ad hoc* measures add up to an enduring answer especially since the result is a further anomaly on top of the UK rebate. It is very probable that fresh problems will arise requiring new mechanisms for limiting net contributions to be dreamed up before long to redress these unanticipated imbalances. Part of the difficulty has to do with the confusion about the objectives of the EU spending discussed previously. On the financing side, it is no great challenge to devise a formula that takes from each member either in proportion to wealth or according to some progressive formula under which the better-off pay a proportionally higher share of their incomes.⁷ On the spending side, it is the nature of EU policies that shapes the distribution of receipts, so that if more equitable shares of spending are to be engineered, the way to do so is to review the policies.

6 Concluding remarks: where next?

The main conclusion of this paper is that the Berlin agreement has created a *Financial Perspective* (see Figure 2) that, while largely preserving the *status quo*, has aggravated rather than resolved the shortcomings in the EU budget. Certainly, the outcome, in the short-term, will be more equitable net contributions, but this has been achieved at the cost of watering-down the financial autonomy of the EU and establishing a pork-barrel approach to budgetary politics. Big decisions have been avoided, notably on CAP reform, and the lack of reform seems likely to make enlargement more of a challenge. A failure to agree would probably have resulted in a political and financial crisis for the EU, and the timing was hardly propitious for a more ambitious reform. But it is hard to escape the conclusion that Berlin, echoing the reluctance at Amsterdam to confront institutional reform, was an exercise in damage limitation rather than an attempt to chart the way forward for the EU.

This prompts the question of where the budget goes next. Although the *Financial Perspective* is to run until 2006, it is hard to see how it can be compatible either with the growing pressures for meaningful reform of the CAP, or with the expectations of the

⁷ Begg and Grimwade (1998) present such a formula, updating an approach set out by El-Agraa (1988).

countries that hope to accede to the EU. On both counts, an Agenda 2002 or 2003 is likely to be needed. However, a much more critical question will be how EU level public finance fits into the economic policy framework. It has been argued here that EMU fundamentally alters the policy environment and that fresh thought is needed on the respective roles of Member State and EU level fiscal policy actors.

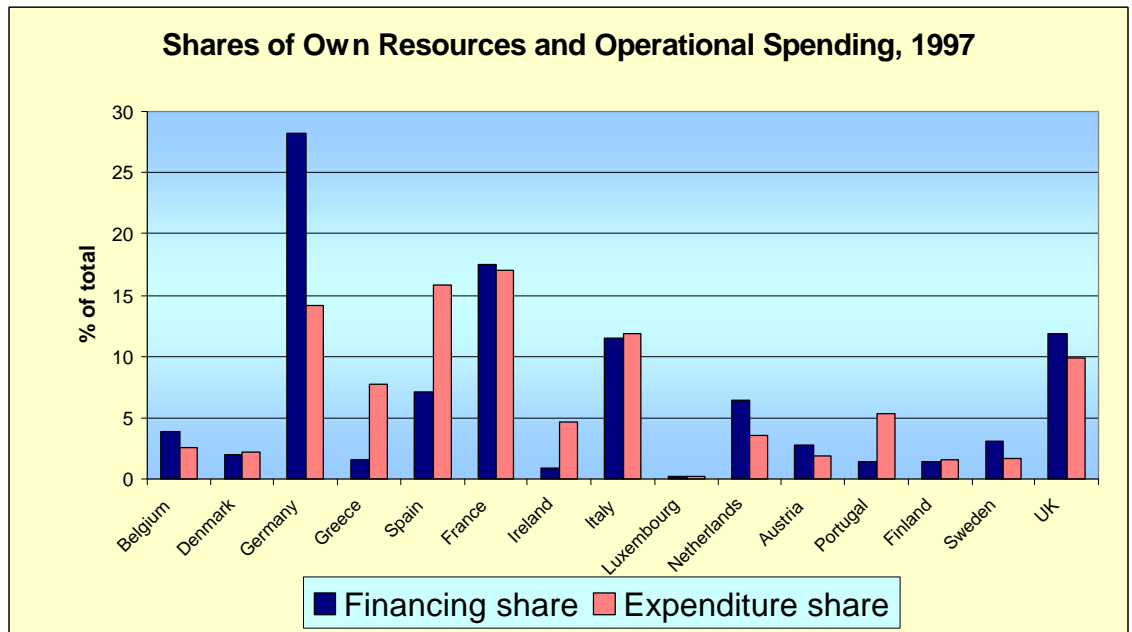
A further examination of policy assignments is plainly needed, even if it is accepted that the EU level is a long way from having either the legitimacy needed to act as a federal government or the acquiescence of Member States to a more extensive role. Perhaps the greatest obstacle here is the depth of resistance in many EU countries to the conventional federal model, although as Inman and Rubinfeld (1997) show, there are alternatives that might suit the EU better. The size and scope of the EU budget also warrant attention as, with a ceiling of 1.27% of GDP, it cannot fulfil the stabilisation or redistribution functions normally assigned to the highest tier of government. The trouble is that the joint decision-trap has been sprung and the various interlocutors cannot easily escape from it. One way forward might be an inter-institutional study group with terms of reference to look into all aspects of the EU budget.

These are thorny questions which highlight the continuing ambivalence about what the EU is and is expected to become. But it can also be argued that pretending that these questions can be ignored is the worst possible answer.

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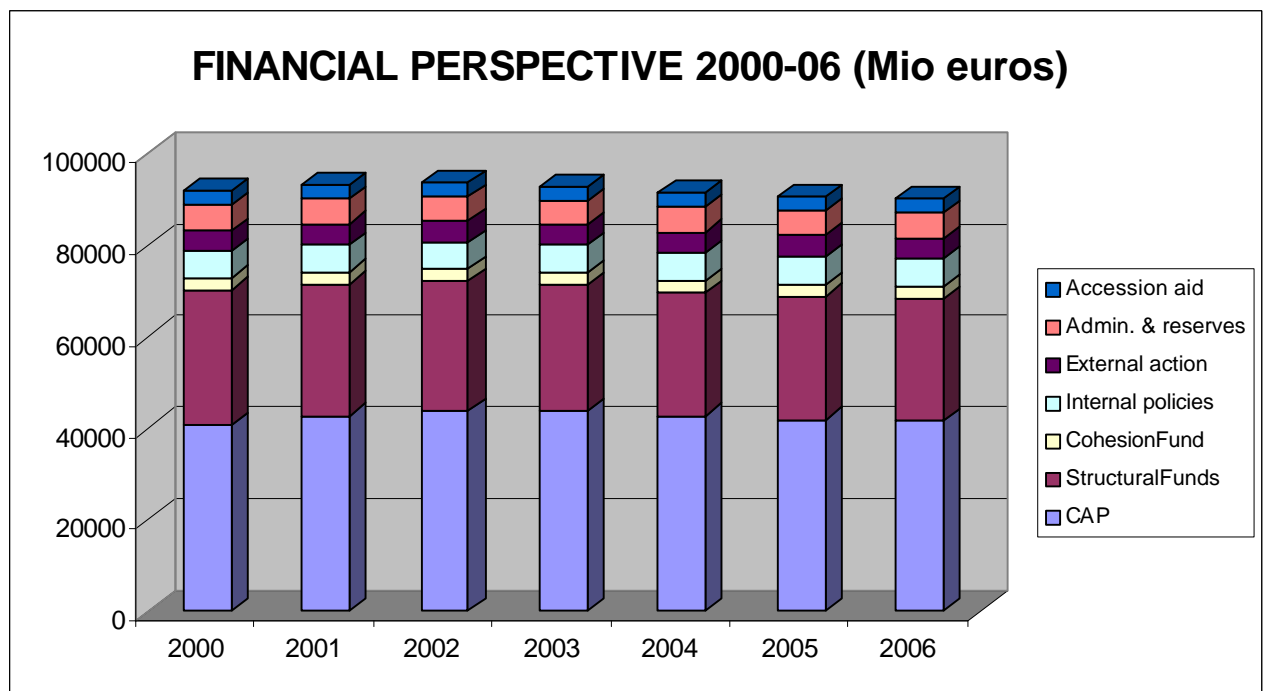
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Figure 1



Source: Author's calculations using data from EC (1998).

Figure 2



Source: Author's calculations using data presented in the Conclusions of the Berlin European Council, March 26th 1999.

Box 1

The 'Particular situations'

(a) For the development of the Lisbon region, a special phasing out treatment of 500 million euros will be provided for Objective 1.

(b) In recognition of the special efforts for the peace process in Northern Ireland, the PEACE Programme will be continued for five years with an amount of 500 million euros, of which 100 million euros will be allocated to Ireland. This programme will be implemented in full respect of additionality of structural fund interventions. The EU contribution to the International Fund for Ireland (15 million euros per annum under heading 3) will be renewed for a period of 3 years. The Commission is invited to make the necessary proposals.

(c) A special phasing out treatment of 100 million euros will be provided under Objective 1 for the transition region of Ireland resulting from the new classification of regions. The reclassification itself will result in an additional allocation to Ireland of 550 million euros under Objective 1. SN 100/99 EN

(d) In order to take account of the particular characteristics of labour market participation in the Netherlands, an additional amount of 500 million euros are allocated to Objective 3.

(e) A special programme of assistance totalling 150 million euros over the period 2000 to 2006 will be established for Sweden in the framework of Objective 3. A special programme of assistance totalling 350 million euros will be established for the Swedish NUTS II regions which meet the criteria laid down in Article 2 of Protocol No. 6 to the Act of Accession for Sweden.

(f) In order to take account of the specific problems of East Berlin in the transformation process, 100 million euros will be added to the allocation for phasing out of East Berlin (Objective 1).

(g) The modification of the safety net provisions will add an additional 96 million euros for Italy and 64 million euros for Belgium to the phasing out allocation for Objective 2.

(h) An additional amount of 15 million euros will be provided for the Hainaut region in Belgium for Objective 1 phasing out.

(i) In view of the particular structural problems resulting from low population density matched with the high degree of poverty, the Highlands and Islands of Scotland will receive a special phasing out programme totalling 300 million euros.

(j) A special financial allowance will be given to Greece, Ireland, Portugal and Spain in order to maintain, for the period 2000 to 2006, the overall average level of per capita aid reached in 1999. The amounts concerned are 450 million euros for Greece, 450 for Portugal, 40 million for Ireland and 200 million for Spain.

(k) A total amount of around 350 million euros will be allocated to Austria inside the Community initiatives.

(l) A total amount of around 550 million euros will be allocated to the Netherlands inside the Community initiatives.

(m) During the examination of eligibility for Objective 2, special attention will be given to areas of the Abruzzi which are adjacent to Objective 1 regions.

Source: Conclusions of the Berlin European Council, March 26th 1999.