SWP Comments

Stiftung
Wissenschaft und
Politik

German Institute
for International and
Security Affairs

Agenda 2007

The first stage of financial negotiations in Europe 2007–2013

Peter Becker

The successful conclusion to the Intergovernmental Conference on the European Constitutional Treaty means that negotiations on the next financial framework for the enlarged European Union—the Financial Perspective or Agenda 2007—constitute the next major area of discussion within the EU. These financial negotiations will set the Union's political priorities for the years 2007 to 2013. On 14 July 2004 the European Commission presented a package of detailed draft legislation specifying the communication published in February 2004 on the key issues of the future and the financial basis of the Union's policies. The new package contains proposals for Regulations on Europe's future cohesion, structural and agricultural policy, two proposals on the reform of the European own resources system, and a draft version of a reformed interinstitutional agreement between the Council, Parliament and the Commission.

Particular attention has been paid to the Commission's idea of abolishing the United Kingdom's special rebate. By raising that issue the Commission poured oil onto an already blazing fire. The proposal provides for a 'generalised correction mechanism' applying to all those Member States affected by an imbalance between contributions to and receipts from the EU budget. The United Kingdom's special rebate, as agreed in Fontainebleau in 1984, should then expire in 2011. The clear—and only—loser resulting from the adoption of this measure would be the United Kingdom, which has already unmistakeably rejected any move whatsoever to tamper with its special rebate. At the same time, the Commission has once again proposed increasing the transparency of the EU's own resources system by opening up a new source of financing linked to tax revenue. This wouldn't entail it demanding any fiscal competence for the Union, but rather introducing a designated EU share either of national VAT revenue or of tax levied on mineral oil or of corporate tax. But the Commission sees no chance of pulling this off at present and therefore suggests that such an innovation take effect in 2014 at the earliest. Nonetheless it wishes to continue the discussion of the last financial negotiations from 1998–99 and prompt the Member States to consider such a major overhaul of the own resources system.

The system behind the EU budget draws a distinction between commitment appropriations and payment appropriations. **Appropriations for commitment** include funds awarded for programmes and projects, which can therefore be tied into the annual budget. They form the basis of an obligation on the part of the Union vis-à-vis a beneficiary. **Appropriations for payments** are funds that can effectively be spent during a budget year. The amount of commitment appropriations and payment appropriations differs, since the funds for multiannual programmes or projects are committed in the year in which the corresponding underlying decision approving them is taken, whereas the payments themselves are actually made successively, as the associated programmes or projects unfold. As a rule, the actual payments made, including the payment appropriations, undercut the volume of commitment appropriations, because for example certain projects are not implemented.

Yet, the actual main legislative proposals for the financial framework 2007 to 2013 contain plenty of potentially explosive material. The Commission is putting up the following general political priorities for discussion for the next Financial Perspective:

- Mobilising economic, social and environmental policy to maintain and sustainably manage natural resources;
- Making the strengthening of European citizenship a priority policy concept; completing an area of freedom, security and justice;
- Developing the EU into a global partner that contributes towards civil and strategic security.

The Commission estimates that attaining these objectives will cost around €1,025 billion in commitment appropriations (on average 1.26% of EU-GNI) and €929 billion in payment appropriations (on average 1.14% of EU-GNI). The sizeable discrepancy between commitment and payment appropriations is due primarily to the way in which the EU's structural funds are managed. Since programmes are planned on a multiannual basis, earmarked funds have to be tied to a particular budget year, but are only actually paid out later, namely when the projects' accounts have been clarified. On the one hand this creates peaks in disbursement during the multiannual financial framework, and on the other hand it generates an overhang of unspent commitments.

The EU budget is due to rise from €116.5 billion in 2006 to €143 billion in 2013, an increase of €26.5 billion, or roughly 22.8% (for payment appropriations; for commitment appropriations the increase is approximately 31%). The Commission based these calculations on a projected average annual growth rate of 2.3% in Europe's GNI.

Proposals to reform the regional policy and suggestions for improving flexibility

Where EU structural funds and cohesion funds are concerned, the Commission is sticking to total resources of €336.1 billion, whereby 78.54% of this amount (€264 billion) is to be set aside for the primary objective "Convergence," the highest support category. For the "Competitiveness and employment" objective the Commission estimates that 17.22% (€57.9 billion) will be required, while the share of the budget to be spent on the third objective—"Territorial cohesion"—is estimated at 3.94%, or €13.2 billion. Accordingly, the Commission has resisted the forceful pressure brought to bear by the EU's net contributing countries, which are calling for a drastic reduction of these totals and a more clearly defined concentration of resources on the highest support category, i.e. the EU's least-developed regions. Furthermore, the Commission is sticking to its guns regarding the attribution of a special status to those

Table 1
Agenda 2007

2007	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*Total*
Commitment appropriations in billions of euro or as a percentage of GNI							
133.560	138.700	143.140	146.670	150.200	154.315	158.450	1,025.035
1.23%	1.25%	1.26%	1.26%	1.26%	1.27%	1.27%	ø 1.26%
Payment appropriations in billions of euro or as a percentage of GNI							
124.600	136.500	127.700	126.000	132.400	138.400	143.100	928.700
1.15%	1.23%	1.12%	1.08%	1.11%	1.14%	1.15%	ø 1.14%
Germany's contribution (percentage share and absolute contributions in billions of euro)							
22.6%	22.6%	22.6%	22.6%	22.6%	22.6%	22.6%	
28.16	30.85	28.86	28.48	29.92	31.28	32.34	209.89

regions, which for statistical reasons following the accession of the eight poorer new Member States in Central and Eastern Europe exceeded the limit of 75% of EU-GNI set for the highest support category. The regions affected are primarily in Spain and the United Kingdom, though some *Länder* in eastern Germany may also be hit.

One new development is the Commission's proposal to draft a comprehensive strategy paper for cohesion policy together with the Member States that identifies firm, clear priorities and objectives for programmes. The Commission is hoping that this will enhance political responsibility and prompt the use of resources to be geared more closely to the EU's Broad Economic Policy Guidelines (BEPGs) and the European Employment Strategy (EES). The Commission intends to draw up an annual report to chart the progress made by Member States in implementing this common strategy. These progress reports will then in turn be submitted to the Spring Council, together with the Commission's annual reports on the EU's Broad Economic Policy Guidelines (BEPGs), the European Employment Strategy (EES) and the Internal Market Strategy (IMS). In this way the Commission hopes to extend controlling and benchmarking procedures established in other policy areas to cohesion policy, while at the same time establishing close ties with the strategic objectives set by the Lisbon Council. At the Lisbon Summit in March 2000, the European heads of state and government set themselves the objective of making the EU the world's most competitive and dynamic knowledge-based economy by 2010. However, this will probably mean that European cohesion policy is more strongly dominated by set political objectives, which threaten to interfere with the objectives agreed by all the actors in the respective programming documents, as well as with operational programmes and interim and final evaluation reports. This approach would not only saddle the EU's Member States and regions with additional coordination and administrative tasks, but also potentially limit their scope for independent decision-making and action when it came to pinpointing priorities.

The Commission has stressed the need for a particularly flexible financial framework, proposing a new instrument for this purpose: so-called 'reallocation flexibility', which shall help to simplify the distribution of resources between individual expenditure headings according to changing circumstances and challenges. For the Financial Perspective's expenditure heading "Competitiveness for growth and employment" the Commission is recommending that funds of up to a maximum of €1 billion taken from as yet non-disbursed structural funds be channelled into a new 'growth adjustment fund' designed to enable the EU to react to short-term economic shocks.

Firmly entrenched positions of net contributors and net recipients

The particularly explosive nature of the subject matter to be negotiated already became apparent on 15 December 2003, when the heads of state and government of six Member States sent a letter to the President of the European Commission, Romano Prodi. In that letter, the net contributors Germany, France, the United Kingdom, the Netherlands, Austria and Sweden emphasised that they had no leeway for an EU budget close to the current own resources ceiling of 1.24% of the EU's gross national income (GNI). In their view, the average expenditure of the next Financial Perspective should at most be stabilised at the present level and be no more than 1% of GNI.

Having checked through the Commission Communication published in February 2004 and after the first round of negotiations in the Council, the Irish EU Presidency submitted its preliminary analysis to the European Council on 17–18 June 2004. That report highlighted the formation of the following distinct groups of likeminded Member States:

1. The group of net contributors that had already announced their view on the own resources ceiling before the Commission published its Communication. The members of this group include Denmark and Finland, in addition to the signatories of the December letter.
2. The group of cohesion countries in the EU of 15 Member States that reject any drastic constraint to the 1% margin. Indeed, some of the countries in question are calling for a rise in allocated resources, but at least support the Commission's financing scheme. This group includes Greece, Portugal and Spain.
3. A group of Member States that doesn't seem to have a firm view yet on the own resources ceiling. This group includes Belgium, Italy, Luxembourg and the new Member States Malta and Cyprus.
4. The group of new Member States from Central and Eastern Europe appear to agree on two objectives: rejecting the strict 1% ceiling and softening the 4% upper limit of national GDP for payments made to them out of the EU budget.

The debated volume of savings

Although the net contributors are not calling into question the own resources ceiling of 1.24% of the EU's gross national income, they are demanding that both commitment and payment appropriations remain clearly below this level. The actual payments made, which currently total some 0.98% of EU-GNI, should also not exceed the 1% limit in the enlarged Union. Consequently, they reject the upper limits proposed by the Commission for payments and commitment appropriations, just as they reject any shift towards the magical own resources ceiling.

The Commission wants to pledge significantly more funds, i.e. higher commitment appropriations, so that appropriations for payments average 1.14% of EU-GNI in total. Compared with the 1% scenario favoured by the net contributors, the Commission's approach would amount to a difference of around €113.6 billion in payment appropriations. If appropriations for commitments are considered for comparative purposes, the difference for the overall period under discussion is approximately €210 billion. This enormous amount is the maximum volume of savings aspired to by the net contributors compared with the Commission's approach. For Germany's present share of 22.6% of the funds provided, this would represent a volume of €47.44 billion over the entire seven-year term of the Financial Perspective where commitment appropriations are concerned, or an annual average of some €6.777 billion. If the payment appropriations planned by the Commission are taken as a yardstick for comparison, Germany would stand to save €22.67 billion, or an average of €3.667 billion per annum.

Table 2
Comparison between the Commission proposal and the 1% scenario favoured by the group of net contributors

	2007	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*Total*
Authorisation for payments in billions of euro								
Commission	124.600	136.500	127.700	126.000	132.400	138.400	143.100	928.700
	(1.15%)	(1.23%)	(1.12%)	(1.08%)	(1.11%)	(1.14%)	(1.15%)	(ø 1.14%)
Net contributors	108.348	110.976	114.018	116.667	119.278	121.404	124.443	815.134
Difference	16.252	25.524	13.682	9.333	13.122	16.996	18.657	113.566
German share of	3.673	5.768	3.092	2.109	2.965	3.841	4.218	25.666
the difference							or	ø 3.667 p.a.

Bearing in mind the Commission's relatively optimistic forecast of average growth of 2.3% in EU-GNI over the next seven years, some additional imponderables arise. The Commission is forecasting growth of 2.2% for the EU-15, of 4.1% for the 10 new Member States and of 5.6% for Romania and Bulgaria, which are scheduled to join the Union in 2007. If actual growth rates turn out to be lower, the Commission's approach regarding payments will shift clearly closer to the 1.24% own resources ceiling, resulting in an additional financial burden on the net contributors. For this reason, the net contributors reject the use of the Commission's proposals as foundations on which to base further negotiations on legislative proposals, whereas many other delegations are generally prepared to accept them as such a starting point.

Sources of conflict and inbuilt breaking points

In view of the marked differences between the way in which the Member States view the Commission's proposal from February 2004, four areas of conflict loom very large in the negotiations:

1. A top-down or bottom-up approach?

The question of the approach to be chosen when drawing up the Financial Perspective is closely tied to the overall sum due to be fixed for the seven-year term of the financial framework. The Commission, backed by the majority of Member States and the European Parliament, is taking a bottom-up approach, namely by first listing the future challenges and tasks handed over by the Member States of the enlarged EU and then calculating the finances needed to do the job. By contrast, the group of net contributors is arguing in favour of a top-down approach, which would begin by capping expenditure at 1% of EU-GNI and only then set the priorities within the duly fixed financial framework.

This argument about the right approach to take will lead nowhere. In principle, the political priorities will have to be set whenever limited resources have to be distributed between competing political objectives, as is also the case where the financial framework of the enlarged Union is concerned. Both approaches will necessarily have to verify the Commission's specifications—i.e. the tasks and objectives to be pursued by the European Union—and look into potential for concentration and any savings that can be made. Since the financial framework for the Common Agricultural Policy was defined by the compromise on agriculture reached in October 2002 and valid until 2013, greater efforts to make savings and the associated scrutiny of European Objectives and tasks can only focus on the second largest chunk of the EU budget, namely the EU's structural and cohesion policy.

2. The political orientation of future structural and cohesion policy

Yet it is in this very area of policy that the accession of eight poorer Member States resulted in substantially greater heterogeneity within the Union, characterised by huge socio-economic disparities and accordingly a greater need for financial support from the Union. The Commission also sees a mounting need to support the Member States in their efforts to boost their economic competitiveness, lower unemployment and foster innovation and development. To this end it intends to tie the European structural and cohesion funds to the objectives set out in the Lisbon Strategy. The Commission maintains that growth and cohesion are complementary concepts; European cohesion policy is an integral part of the Lisbon Strategy and should therefore take up its objectives and at the same time become the main instrument for implementing the Lisbon objectives, together with national and regional development programmes. The net contributors in particular vehemently reject this re-orientation of the objectives. The way that the Union's structural and cohesion funds are spent will supposedly be determined not by the objectives of the Lisbon Strategy, but solely by the aim set out in Article 158 of the EC Treaty: to reduce existing differences in structural development between various regions by promoting the most disadvantaged areas. The net contributors argue that most of the instruments for implementing the Lisbon Strategy are supposedly situated at the national level and that there is no need for any additional spending programmes at the European level. Instead, what is required is the constant exchange of information and competition to find the best way of attaining the Lisbon objectives.

3. Room for manoeuvre in the EU budget

Since the Union, unlike its Member States, may not take out loans to compensate for upsets in the economy and their impact on budgets, the Commission has limited means of swiftly, efficiently and flexibly reacting to economic or political changes. Consequently, the Commission has proposed two new instruments designed to make the Union's budgetary system more flexible: reallocation flexibility and the growth adjustment fund. However, the more important measures are the reduction of the number of budget headings from eight to five and the annual technical adjustments feasible in the course of the budget procedure.

The very large discrepancy of around €96 billion between the payment and commitment appropriations estimated in the Financial Perspective also offers the Commission additional leeway. Having said that, the considerable increase in commitment appropriations in comparison with the present financial period and the resulting growing discrepancy with payment appropriations, could lead to a shift in the cash payments and to a mounting overhang of non-realised commitments. For 2013 the Commission anticipates that the amount of committed, but not yet distributed funds will total €181 billion, as against an estimated overhang of some €100 billion at the end of 2006. Not only will this considerable difference lead to major imprecision regarding forecasts of the actual budget volume for the years 2007 to 2013; the group of net contributors also fears that some expenses will be postponed to the next-but-one financial framework, due to start in 2014, with pledges being made in the next financial period that can only then be honoured during the subsequent period.

To counter this problem of steadily growing overhang, the so-called 'n+2 rule' was agreed for the current support period of the structural funds. Under this rule, all resources not tied up within two years of their authorisation by the Commission are forfeited. Funds that have not been disbursed, for instance because an approved project or programme failed to materialise or because less funding was required than had originally been applied for, will then either be reallocated to the flexibility instrument, up to a maximum of €200 million, or transferred back to the Member States. Just how the Commission in the light of this arrangement nonetheless calculates the massive total of surpluses and justifies the need for them will be key issues in the ongoing negotiations.

4. Net balance and the United Kingdom's special rebate

By proposing the abolition of the United Kingdom's special rebate, the Commission has rekindled a debate that was conducted during the previous round of financial negotiations back in 1998–1999. In February 1998 the German federal government, together with the Netherlands, Austria and Sweden, proposed a general correction mechanism, that would supposedly be based on an upper limit of 0.3 to 0.4% of national GDP. The Commission presented that model in its report on the workings of the own resources systems in October 1998, albeit without openly advocating its introduction. Now, nearly six years later, the Commission is taking up the proposal once again and putting it on the negotiating table for the governments of the Member States. The Commission suggests that all Member States contributing more than 0.35% of their GNI to the EU-budget should benefit from a correction. The maximum amount eligible for such a correction is limited to €7.5 billion, and the proposed ceiling for compensation received is set at 66% of the respective net balance. In this way the Commission has rather shrewdly sown the seeds of discord between the already unstable group of net contributors, for the general correction mechanism would offer all net contributors except for the United Kingdom a chance of obtaining EU funds for the implementation of the Lisbon objectives and at the same time enable them to clearly lower the burden on their own net account. According to the Commission's calculations, the United Kingdom, on the other hand, would almost double the share it contributes to the EU budget. At present the United Kingdom contributes 0.25% of Britain's GNI to the EU budget, but this figure would leap to 0.51% and still total 0.46%, even taking account of the proposed transition period until 2011. The United Kingdom's special rebate, which still totalled somewhere in the region of €4.9 billion in 2002, could thus be almost halved. At the same time, Germany's negative balance, currently at 0.54% of Germany's GNI, could be reduced to 0.49%. Initial calculations suggest that this would ease Germany's burden by around €1.2 billion, and comparable effects would apply to the other net contributors.

Future milestones

The heads of state and government have confirmed their intention on several occasions to reach agreement on the new Financial Perspective by June 2005 at the latest. To that end the Member States will continue their negotiations from September on the basis of the Commission's proposals and analysis. The newly elected European Parliament will then set out its view on the future financial framework. In April 2004, in a first opinion, the previous Parliament agreed on guidelines, but did not wish to anticipate the position adopted by its subsequently newly elected successor. Parliament's viewpoint is important insofar as the institution has to confirm any compromise reached by political arrangement between the heads of state and government in a new interinstitutional agreement. The Commission is pressing to conclude negotiations shortly, so that implementation can begin early in 2006, especially the planning for the structural fund programmes. Only this run of events would guarantee that the programmes in question could be launched on time on 1 January 2007 and that there was no reoccurrence of the delay that occurred at the start of the current support period.

However, the announcement by the United Kingdom and France of their intention to have the European Constitutional Treaty ratified by a referendum has strengthened the bargaining position of these two protagonists. A general election will be held in the United Kingdom by June 2005 at the very latest, and only after that election does Prime Minister Tony Blair intend to put the Constitutional Treaty to the British people. Likewise, in France the referendum will only be held during the second half of 2005. Bearing in mind the Euroscepticism or open criticism of the European Union in the United Kingdom and France, it seems somewhat unrealistic to expect it to be possible to seriously question United Kingdom's special status with respect to its net balance or France's interests in protecting French farmers. A far more likely scenario is that both Tony Blair and Jacques Chirac will underscore their special national interests even more clearly in the final phase of the negotiations.

This means there are just two windows of opportunity for reaching agreement on an overall compromise: in spring 2005, before the British general election and referenda, or in autumn 2005, after the referenda, but sufficiently far away from the Bundestag elections scheduled for 2006. For should the negotiations drag on into 2006, Germany's leeway in the area of European policy will increasingly dwindle, shrunk by domestic political debate about savings and cuts in social insurance systems. Having said that, in the enlarged European Union some election or referendum is being held at practically any given moment, allowing virtually no windows of opportunity for reaching political compromises on fundamental issues. The leeway for systemic changes, which always entail a shift in the distribution of burdens and benefits, is becoming extremely small.

The prospect of such a scenario is stepping up the pressure on all actors to reach a workable compromise in the negotiations. Germany's federal government must also conserve its ability to compromise, despite its exposed negotiating position, which is fixed with respect to the issue of net contributions. As the negotiations go on, it will be forced to submit specific proposals in support of its key demand, that the EU's budgetary resources be concentrated on genuinely European, priority tasks, and thereby reduce the funding of desirable, but non-essential projects. It should therefore use the current breather in the negotiations to set these priorities accordingly. Fleshing out its position will also entail seeking additional allies to back Germany up on individual points. If the federal government continues to insist that the funds from the European structural funds should primarily be spent on helping the least-developed regions of the enlarged Union to catch up with the rest, it will find some grateful allies among its new neighbours in Central and Eastern Europe. However, bearing in mind the still early stage of the negotiations, this mustn't be allowed to prompt the disintegration of the group of net contributors.

SWP
Stiftung Wissenschaft und Politik
German Institute for International and Security Affairs

Ludwigkirchplatz 3–4
10719 Berlin
Telephone +49 30 880 07-0
Fax +49 30 880 07-100
www.swp-berlin.org
swp@swp-berlin.org