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REFORMING THE EUROPEAN FINANCIAL FRAMEWORK

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Reforming the European Financial Framework [1]

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Abstract

On April 4th, 2006, the European Parliament, the European Commission and the member states agreed on a new Financial Framework for the seven year period 2007-2013 by signing the Interinstitutional agreement on budgetary discipline and sound financial management. One crucial precondition had been the inclusion of a midterm review clause agreement inviting the Commission "to undertake a full, wide ranging review concerning all aspects of EU spending, including CAP [Common Agriculture Policy], and of resources, including the UK rebate." The debate about the substance and goals of this complete overhaul began this spring with the European Parliament's Lamassoure Report on the reform of the EU's own resources system and the adoption of the Commission's Consultation Paper "Reforming the budget, changing Europe" on September 13th, 2007.

This Paper starts with a short examination of the final compromise on the Financial Framework 2007-2013 and then describes the main lines of conflict defining the very controversial negotiations. Based on this analysis it then identifies the main areas of reform and tries to formulate reform options for the two main spending blocks, the CAP and the cohesion policy, as well as for the revenue side of the EU-budget. The search for the European added value will almost certainly become the key goal of the review. Crucial for the success of the revision process, however, will be the political environment of the process. It is almost guaranteed that the European Parliament will become a major new player when using its new rights granted by the reform treaty. Finally, the paper concludes with the discussion of the prospects of success of the review.

1. Introduction

On June 7th 2007, in the shadow of the controversial debates on the mandate for the Intergovernmental Conference, the Council adopted a Decision on the system of the European Communities' own resources including a new mechanism to calculate the UK rebate. This Council Decision marks the official end of the marathon negotiations on the Financial Framework 2007-2013, which began back in February 2004. On April 4, 2006 the representatives of the European Parliament, the Council, and the European Commission agreed on a new Interinstitutional Agreement on budgetary discipline and sound financial management, whose central component is the seven year Financial Framework.

At first glance, the EU's capacity to regulate and reform its financial and budget system thus appears to be in functioning order. However, the fact that these very difficult negotiations had been finalized the was at best a cause for relief, rather than joy. A closer examination shows that there are good reasons to doubt whether this system will be able to guarantee the Union's capacity to act in future and whether the present structure of the EU budget can still cope with the current challenges facing the Union. It was no coincidence that the first public statements by the heads of state and government after their compromise on the new Financial Framework (reached after very hard negotiations in the small hours of December 17, 2005) exhibited deep-seated mutual mistrust, and enormous scepticism about the whole future of this system and the prospects of ever reaching such a consensus again. Furthermore it was no coincidence that agreement about the Financial Perspective was only possible because at the same time a thorough overhaul of the system had been agreed. A revision clause in the European Council conclusions provides for a "comprehensive reassessment of the financial framework," including both revenue and expenditure. The European Commission is called on "to undertake a full wide-ranging review" and to present a report in 2008/09, on the basis of which the European Council will then "take decisions on all the subjects covered by the review" which are to be taken into account in the negotiations on the next Financial Perspective.[2]

In the light of the difficult negotiations and the obviously unconvincing final result, the prime question to be answered in the upcoming revision-negotiations should be whether this process, the practice of negotiating huge seven-year financial packages, is really the most appropriate way to guarantee the proper financing of the Union and to secure the most efficient use of EU-resources. However, the starting point of the revision clause has to be a

[2] Council of the European Union, Note from Presidency to European Council, Subject: Financial Perspective 2007–2013, doc. 15915/05, December 19, 2005.

thorough examination of the Agenda 2007, i.e. the Financial Framework 2007-2013, process and the final compromise.

2. The Outcome of the Negotiations

With a total volume of appropriations for commitments of €864.3 billion, the latest Financial Perspective corresponds to the agreement reached by the heads of state and government in December 2005. This new agreement seems to be much closer to the demands of the six net contributors (whose letter of December 15, 2003, called for the Financial Framework to be limited to 1 percent of the EU's GNI or approximately €815 billion) than to the wishes of the European Commission and the European Parliament. The Commission had proposed on February 10, 2004 a total budget volume of €1025.026 billion in appropriations for commitments (on average 1.26 percent of the EU's GNI) for the Financial Framework, and the European Parliament had made it very clear in its resolution of 8 June, 2005, that it wanted to see more money become available for the years 2007 to 2013 (see Overview 1).

Closer examination, however, shows that the final compromise of April 2006 is characterized by the creation of new flexibility reserves outside the budget framework. This had been one of the European Parliament's priorities in the interinstitutional negotiations[3]. Adding up these special funds we find an additional volume of about €36 billion. Thus the actual available funding volume of about €900 billion is considerably higher than the €864.3 billion officially stated in the Interinstitutional Agreement. This method of excluding special funds from the scope of the Financial Perspective 2007–2013 corresponds to practices familiar from earlier budget negotiations. It makes it easier for the two EU organs - Council and Parliament - to agree on a compromise that allows both sides to save face.[4]

Furthermore the EU parliamentarians succeeded in making a number of quantitative and qualitative changes to the original political understanding reached by the European Council.[5]

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[3] This agreement was negotiated in four trialogue meetings in early 2006 (January 23, February 21, March 21, and April 4) by representatives of the European Parliament, the European Commission, and the Council Presidency. After the Council of Ministers adopted the compromise of April 4 by written procedure the plenary of the European Parliament also gave the new Interinstitutional Agreement on Budgetary Discipline and Sound Financial Management a clear majority on May 16, 2006 (440 in favor, 190 against, 15 abstentions).

[4] In the negotiations the Council focused primarily on the observance of budget discipline and restricting the volume of the budget and that the European Council's compromise remains largely untouched in all other respects. The European Parliament, on the other hand, attempts to increase the overall volume of the Financial Framework in order to allow it to pursue its institutional interests in the individual policy fields. The intransparency of the special funds allows the Council to claim to have restricted the overall volume of the EU budget while conversely the European Parliament can also resort to the special funds to boost spending.

[5] European Parliament, Report on the Interinstitutional Agreement on Budgetary Discipline and Sound Financial Management.

Overview 1: Proposals for the EU Budget 2007–2013 (by heading, million €)

Heading	*EU Commission (Feb. 10, 2004)**	*European Parliament (June 8, 2005)*	*Luxembourg proposal (June 17, 2005)*	*British proposal (Dec. 14, 2005)*	*European Council agreement (Dec. 17, 2005)*	*Interinstitutional Agreement with the European Parliament (April 4, 2006)*
1a Competitiveness (Lisbon Strategy)	121,685	110,600	72,010	72,010	72,120	74,098
1b Cohesion (Structural Funds)	338,710	336,330	309,594	298,989	307,619	308,041
2 Preservation and management of natural resources	400,275	396,306	377,800	367,294	371,245	371,344
of which: agricultural market expenditure and direct payments	301,074	293,105	295,105	293,105	293,105	293,105
3 Citizenship, freedom, security and justice	20,945	16,054	11,000	10,270	10,270	10,770
4 The European Union as a global player**	84,650	63,985	50,010	50,010	50,010	49,463
5 Administration	57,670	54,765	50,300	49,300	50,300	49,800
6 Compensations (Bulgaria, Romania)	0,8	0,8	0,8	0,8	0,8	0,8
Commitment appropriations	1025,355	974,840	871,514	809,319	862,364	864,316
in % of GNI	*1.240*	*1.182*	*1.057*	*1.03*	*1.046*	*1.048*

* In the Commission's proposal, administrative costs were shared out among the different headings. In order to maintain comparability with the European Council's table the administrative costs are combined here according to heading 5, administration, in the Commission's list in Fiche No. 17 "Indicative estimates of administrative expenditure" of May 12, 2004.

** In this row, note that in the Council's negotiations funding for cooperation with the ACP states through the European Development Fund totalling €22,700 million was excluded.

These amendments and savings in administrative expenditure and excluding the Emergency Aid reserve from the budget increased the volume of the EU Financial Framework for 2007–2013 by additional € 4 billion, bringing total spending to 1.045 percent of the GNI of the EU25 (in commitment appropriations).[6]

Out of the total of around €864 billion, approximately €308 billion are spent on the European structural funds and some €293 billion are earmarked for market-related agricultural expenditure and direct payments made to farmers. This leaves about 70% of the budget for the Common Agricultural Policy and European cohesion policy. A further €70 billion are set aside for the development of rural areas and environmental policy; but €33 billion of this total are reserved for the 10 new member states plus Bulgaria and Romania. All in all, the agricultural budget totals approximately €363 billion.

The European structural funds are divided into two roughly equal sums, one covering the least-developed regions in the old member states, the other those in the new. Although the amount earmarked for the new member states is well below the total originally called for by the Commission, in future the co-financing share that the poorer member states will have to contribute out of their national budgets will be reduced by 10 percentage points. Furthermore, private investment costs and even VAT will be included in this co-financing share. Additional relief is provided by a one-year extension from two to three years of the period during which the funds centrally allocated in Brussels can be claimed. These technical adjustments had been very much in the interest – and indeed met - the needs of strained national budgets as well as the frequently overstretched managers of the European funds in the new member states than a simple increase in the overall funds in question.

A prominent feature of the new Financial Framework is a marked increase in the number of ‘special measures’ for individual member states. Whereas Agenda 2000 – as the preceding Financial Framework was called – contained 13 special measures worth a total of €5.265 billion, the new Financial Framework contains a total of 18 measures worth well over €10 billion. The associated provisions concern items ranging from special payments made to individual regions (Ceuta and Melilla, Corsica, Northern Ireland, Prague, the poorest regions in eastern Poland, Germany’s eastern federal states, Bavaria and Austria’s border regions *et al.*) to special measures for dividing up the funds of the new financial instrument EAFRD (European Agricultural Fund for Rural Development) between a few member states in Western Europe. The countries standing to gain the most from such exceptional measures will be Spain, with special payments totalling at least €2.1 billion, Italy (€1.9 billion) and Poland (€1.2 billion).

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6 This agreement became possible after the European Parliament withdrew its original demand for the Financial Framework to be increased by €12,000 million over and above the compromise of December 2005, and the governments of the EU member states were willing to shift somewhat from their original compromise.

At the same time, various special measures were introduced on the income side of the Financial Framework to reduce the negative balances of the so-called 'net contributors' Austria, Germany, the Netherlands and Sweden. In this way, Sweden and the Netherlands managed to negotiate substantial reductions in their gross contributions.

Finally the British rebate will be cut by a maximum of €10.5 billion in the period 2007–2013 and this reduction will also extend beyond the year 2013. After a phasing in period between 2009 and 2011 the United Kingdom will assume a greater share of the additional burden on EU structural policy arising from the EU's eastward enlargement, but will continue to benefit from its full rebate on agricultural expenditure even now that the EU has 10 new member states.

3. The Defining Lines of Conflict

Two fundamental conflicts which defined the previous battles over the EU's Financial Perspectives again characterized the latest round of negotiations:

1. There was friction between the "net payers" and "net recipients" - in other words between those member states that pay more into the EU budget than they receive from it and those where the balance is positive. Those member states most interested in a binding commitment to budgetary discipline and burden-sharing squared up to the countries that expect from the EU both financial solidarity and active efforts to promote economic and social cohesion.
2. The running quarrel continued between the United Kingdom and all the other member states over the existence and level of the British rebate. The United Kingdom is the only member state to enjoy the right to an automatically increasing budget rebate, which the other member states have to fund through higher contributions.[7]

In addition, one special feature of the Agenda 2007 negotiations had been that the domestic financial difficulties of the EU's biggest contributors, caused by a long period of weak growth, came to the fore very clearly for the first time. The financial flexibility of these member states was also so clearly restricted by the strict debt criteria of the European Stability and Growth Pact that a generous expansion of the EU budget was excluded from the very outset. On the other hand, and in view of the glaring disparities in prosperity between the old and new member states in the expanded EU, the need for funds had plainly grown; this is why calls to increase the budget were particularly strong.

[7] This exception was introduced in 1984 to redress the structural imbalance between the United Kingdom's contributions to the EU budget as a relatively wealthy country and its low level of receipts from Brussels. Thus this conflict too is part of the "juste retour" way of thinking, in other words the logic of the net balance. Britain responds to criticism of its special role and the budget rebate by attempting to push through greater cuts in the EU's agriculture budget, which London calls the "French check."

However, the net-payer-logic dominated over all other considerations and showed in particular that it is still the EU's member states that shape the budget negotiations: For them the development of their own net balance is the decisive criterion for assessing any potential outcome of negotiations. Any change in EU revenues or expenditure is assessed in terms of its effect on the country's own balance of payments into and out of the EU budget, and thus placed in a national cost/benefit context dominated by fiscal considerations. Under this logic, each member state works to increase spending in those policy fields where it can count on a high inflow of funds; wherever its own returns would be expected to be less than average it calls for cuts.

Analyzing the experience of previous funding negotiations allows us to conclude that when all the member states conduct their negotiations strictly according to the outcome for their national net balance there are a number of negative consequences. Firstly, the negotiations often came to situations of deadlock with aspects of crisis. It requires long and difficult talks in the final phase of negotiations to find a compromise involving a large number of *quid-pro-quo* deals. Yet, because these are always preceded by harsh differences of opinion the final agreement is generally perceived, at least publicly, as the lowest common denominator. Certainly it is not perceived as a forward-looking understanding but at best as a deal hammered out to avert greater harm. This perception confirms and intensifies the already negative public image of the Union and its organs. Thus the conflicts played out in public and the negative connotations of the compromise cause Europeans' approval of the EU to fall further still.

This is not the only negative influence on the European integration process. The net-payer-logic and assessments dominated by national fiscal interests also prevent solutions orientated on a common European interest. The participants show little inclination to venture away from well-trodden negotiating paths. Any fundamental change to the negotiating framework at first brings only increased insecurity and reduced predictability, especially where the development of the national net balance is concerned. So, as a rule, the member states stick by existing agreements and merely attempt to influence the outcome of the negotiations by twiddling with existing controls. The result of this kind of behavior is that necessary modifications are delayed and the results are often inadequate or come too late. Additionally, once compromises have been reached and exceptions agreed (and concessions made too), these tend to become entrenched. Because such compromises can subsequently only be altered by consensus they thus attain a binding status that is equivalent to European treaty law.

It is thus the special format of the negotiations - and especially the net-payer-logic - which not only structures the rationales of the national positions but is also responsible for the sometimes inefficient use of European funds and hence in a mid term perspective also for the poor legitimacy of European policies. It is not the revenue or the spending side of the EU-budget which structure the negotiations and the national positions; it is instead their interplay and the effect on the net-payment-balance which the national governments calculate. For that reason, it is important that the European Council's conclusions on the overhaul of the Financial Perspective explicitly link the revenue and spending sides as the two main components of reform.

4. Reform of Spending Policies

The existing EU financial framework contains a series of incentives for the EU institutions to reinforce their inherent institutional interests. Because the European Parliament bears no responsibility for funding the EU budget but nonetheless is naturally interested in expanding its political remit, it is easy for MEPs to call - as they often do - for new and expensive EU programs. The European Commission, too, is attempting to expand its radius of action beyond its powers allocated to it by enlarging expensive EU programs. By contrast, the member states in the Council, which fund the EU budget through their contributions, are in general interested in restricting spending and maintaining budgetary discipline.

Therefore in order for the EU budget structures to be thoroughly overhauled, a political decision to rethink the EU's spending priorities is required. At the center of this debate we often find the concept of European "added value".[8] Both the Commission and the member states have also attempted to use the latest round of negotiations for a discussion about a possible European added value to be provided by the common policies.[9] In its conclusions of December 16/17, 2004, the European Council was already calling for all the EU's finance-related measures not only to comply with the general principles of subsidiarity, proportionality, and solidarity, but also to produce added value too. Although the member states were able to agree on the fundamental goals and the necessity of a general added value, putting an exact figure on the added value is still controversial and remains the decisive point. And although all the member states say they want to shift spending priorities to allocative policies and modernize the EU budget (and, indeed, all the EU institutions repeatedly point to the new challenges for the Union and have committed themselves to

8 Tarschys, *The Enigma of European Added Value*.

9 The Commission defined the assessment criteria for "European added value" in its communication on Policy Challenges and Budgetary Means of the Enlarged Union 2007–2013 of February 10, 2004, in order to justify its proposed spending increases. It defined the added value as follows: "The Union's value added lies in transnational and Europe-wide action. Here, national authorities are ill-equipped to take into account the full benefits or costs of their actions. Effectiveness requires large critical masses beyond the reach of national governments alone, or in networking efforts made at national level. Common policies, as established by the Treaties, can deliver these benefits, through a mix of regulation, coordination, and financial resources." European Commission, Building Our Common Future: Policy Challenges and Budgetary Means of the Enlarged Union 2007–2013, COM (2004) 101 final, February 10, 2004, 5.

ambitious goals), in the recently concluded funding negotiations it still proved impossible to agree on fundamental structural reforms. The added-value debate is drowned out by the net-payer-logic and *status quo* thinking of the individual states.[10] The forces of inertia were thus stronger than the desire to change course.

However, the Common Agricultural Policy and the Structural and Cohesion Policy remain the EU's greatest spending policies. Therefore the main focus of efforts to reform spending policy will have to focus on these policies.

In its reform initiatives for the CAP to date, the EU has pursued the twin goals of maintaining and consolidating the multifunctional European agricultural model while at the same time making European agriculture internationally competitive.[11] Both goals require agricultural reform to continue, which means decoupling direct payments from production and further liberalising the agricultural markets. However, the point currently reached in reform of European agriculture is plainly insufficient. Even after the various attempts to reform the CAP, neither the dominance of agricultural spending in the EU budget nor the criticism of the CAP at the world trade talks have been significantly reduced.

Even the initiatives to define new goals and tasks (such as protecting the environment and rural areas) also serve primarily to justify the continuation of subsidies. Although it is argued that EU payments reward a service provided to society by farmers, neither the stronger focus on supporting rural areas nor the environmental and animal welfare motives of the cross-compliance rules are really convincing. Like their predecessors, these new instruments of the multifunctional European agricultural model exist primarily to justify distributive political goals. Only to a limited extent are they about a European added value that needs to be funded from the EU budget, especially as there is no transparent comparison of the costs of these new services with the payments made for them out of the EU budget.

Hence, for the European Common Agricultural Policy the question remains justified as to why a relatively small branch of the economy with a relatively small share of employment has to be continuously and disproportionately subsidised through the community budget - especially in a context where the distribution criteria are intransparent, in no way conform to the idea of

[10] The best example is the new European Globalization Adjustment Fund, which should be interpreted less as proof of an orientation on mutual European added value than as a sign of the continuity of the compensatory function of the EU budget.

[11] Since the McSharry reform of 1992 (and the subsequent Fischler reform of 1999 and the Luxembourg reform of 2003) the CAP has been subject to a continuous process of revision and adaptation whose aim has been the separation of direct income subsidies for farmers from the production of agricultural products. The CAP's subsidy policy has gradually shifted from protectionist production-linked price support policies to direct income subsidies paid to farmers. The latest reform of 2003 also made direct payments conditional on the observance of European and national standards for environmental protection, animal welfare, food safety, and health and safety at work (cross compliance) and increased funding for the second pillar of the CAP, rural development (modulation).

community solidarity, and where farmers are not always subsidized equally and appropriately.[12]

The first starting point for further reforming the CAP remains making greater use of the instrument of co-financing, especially where the new member states were granted the option of facultative co-financing of direct payments in the accession negotiations.[13] The additional increase in budget funds in the co-financed second pillar of the CAP for rural development (modulation) will only produce the desired savings if there is a corresponding cut in funding in the non-cofinanced first pillar. There is no reason why direct payments to farmers should not be co-financed. This mode of funding is normal in European Structural Policy and would by no means automatically lead to the renationalization of a communitized field of policy (the gloomy scenario always conjured up by France). Instead, this procedure could lead to stricter budget discipline and more efficient application of EU funds. In a second step the share of the EU budget spent on the first pillar of the CAP should be reduced still further. This will be unavoidable if the funds needed for allocative policies are to be released.

In 2008, the expenditures used to subsidise the European agricultural sector, that means the first pillar of the CAP, will be replaced as the biggest heading in the EU budget by the European Cohesion policy. The purpose of European structural and cohesion policy is to counteract the different levels of development in the different regions of Europe and in particular to reduce the development gap in regions that are structurally weak in relation to the EU average through deliberate measures (goal of convergence), in order to increase economic and social cohesion in the Union (goal of cohesion). Beside this, the European Structural and Cohesion Policy is the most visible example of the compensatory function of the EU budget and as such fulfils an integration policy function.[14]

The starting point for the negotiations for the funding period beginning in 2014 will be fundamentally different from that starting point for the round of negotiations that has just finished, because for the first time the decision on the regulation of the goals and the distribution of funds can be made by qualified-majority-voting. Nevertheless, the overall budget of the Financial Perspective - and with it the financing available for the Structural Funds - still has to be agreed upon unanimously. The impetus for reform provided by the introduction of

12 Baldwin, *The Real Budget Battle*, and Baldwin, *Who Finances the Queen's CAP Payments?*; see also the internet page www.farmsubsidy.org.

13 This is because the new member states are only slowly being "phased into" the direct payments system. In 2007 farmers in the new member states will receive 40 percent of the level of direct payments received by their EU15 colleagues; the rate will then be raised by 10 percent each year until 2012. However, the new member states are allowed to augment the EU direct payments from their national budgets.

14 The establishment of the European Regional Development Fund (ERDF) in 1975 can be traced back to Britain's insistent urging for compensation for the underdeveloped British agricultural sector and the resulting low level of receipts from the EU budget. The southern expansions of 1981 and 1986 (Greece, Spain, and Portugal) led to a doubling of the Structural Funds, and the price of agreement on European currency union in the Maastricht Treaty was compensation for the most backward member states in the form of the European Cohesion Fund.

majority voting in the statutory instruments of the Structural Funds might therefore remain limited. However, this modification of the mode of voting could be used for technical adjustments under the legislative procedures. This reduces the veto options of individual states, and as a result the chances of changing spending priorities should be improved.

In the last negotiation round, the crucial element needed to modernize the EU-budget and to make the EU's cohesion policy more effective had been the close linking of cohesion policy to the European Lisbon agenda, which has the objective to make the EU more competitive and to deliver more jobs. The new Regulation for the structural funds stipulates in its Annex IV that at least 60 percent of the funds available to the poorest regions of the old member states and 75 percent of the funds available for all other regions of the EU-15 have to be earmarked to finance projects in accordance to the European Lisbon Strategy for growth and employment.[15]

The new European structural funds, characterized by an obvious similarity between the instruments which guide the Lisbon strategy and cohesion policy[16], aims at more efficiency of this spending policy and an enhanced European added value. But the Lisbon-oriented objectives designed for the old member states will not solve the problems and the fundamentally different challenges in the new and in general poorer member states. The EU is therefore running the risk that European cohesion policy will in fact contain two different cohesion policies with different funding priorities for a long period. The budget reform has to tackle this problem and probably re-direct additional funds from the old to backward regions in the new member states.

The future scarcity of funds for regions in the old member states might be compensated for by granting a greater subsidy flexibility for those regions in the old member states that also suffer structural problems but are not necessarily dependent on aid from the EU budget. So the reform process will have to combine the goal of concentrating funds with those of flexibility and subsidiarity.

5. Reforming the EU's Own Resources System

If the member states really want to make the EU's own resources system fair and transparent, the revision debate will have to address the problem of the British budget rebate and the exceptions and rebates for the other net contributors. The reason, of course, why the abolition of these rebates was not possible in the latest round of negotiations lay in the rule

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[15] Council Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999, Official Journal of the European Union, L 210/25 from 31.7.2006, Article 9 (3) and Annex IV.

[16] Polverari, McMaster, Gross, Bachtler, Ferry and Yuill, *Strategic Planning for Structural Funds in 2007-2013. A Review of Strategies and Programmes*.

that the own resources decision had to be adopted unanimously. This grants the respective beneficiaries - especially the United Kingdom - a strong veto position. Much more important, however, is the open-ended validity of the own resources decision, which cements this *status quo* indefinitely. So the first step would have to be to give the own resources decision a time limit and to tie it to the Financial Perspective. It is, however, this very lack of expiry date that appears unrenounceable for the United Kingdom, because it is what gives the British their veto.

In 2004, the Commission initially proposed a generalized correction mechanism in order to gradually level out the United Kingdom's special position *vis-à-vis* the other net contributors and to share out the burden of contributions more fairly. But it proved impossible to implement this solution. On the other hand, it would be relatively easy to achieve agreement on completely abolishing the VAT resource.[17] Retaining the VAT resource means retaining instruments that allow negative any net balances of individual member states to be compensated for through targeted adjustments in the calculations. However, the overall volume that the "additionally burdened" member states would have to bear certainly appears reasonable in relation to the potential gains in transparency and efficiency. The prospect of achieving savings in administrative costs, and the costs involved in calculating the VAT resource, should make it easier to foster approval for this simplification of the funding system.

By concentrating decisively on the GNI resource and continuing to reduce the (already almost irrelevant) traditional resources (customs duties and sugar levies) the EU would come closer to the usual funding systems of other international organizations of states. So the discussion about an autonomous source of funding is back on the agenda, especially given that the Commission has already announced that it will be making this question a central issue of the revision debate.

Even if the EU's sources of revenue are called "own resources," the Union still possesses no form of funding over which it is able to decide autonomously. The proponents of an own resources system based largely on tax revenues for the EU advance political as well as economic arguments.[18] Alongside the aspect of increasing the EU's financial autonomy, which is desirable from the point of view of integration, they stress in particular that this would improve the transparency and openness of the shared funding system for the European taxpayers. A more direct connection between the budget and the citizens would potentially increase the accountability of the EU's budgetary organs (Council and Parliament)

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[17] The VAT contributions come from the member states' national budgets but do not necessarily have to be financed out of the national VAT revenues. The contributions are calculated for each member state on the basis of a harmonized VAT base, where the level is capped by means of a maximum rate of call. The base for calculating the harmonized VAT resource is also restricted to 50 percent of the gross national product of the respective member state in order to compensate for the regressive effect to the detriment of the less affluent member states.

[18] Biehl, *Zur Reform der EU-Finanzierung*; Henke, Milbrandt, D*ie künftige finanzielle Lastenverteilung in der EU*, 119–35.

to the Union's citizens. At the same time the necessity to democratically legitimize the EU's budget would increase, and in the long term this could lead to a broadening of the Union's legitimacy base as a whole. More strongly integrating the European Parliament and increasing its responsibility would shift MEPs' focus from spending policy more to the revenue side of the EU budget. This could also have a positive impact on European budget discipline, because increased cost transparency and budgetary responsibility could have a cost-damping effect. Overall the budget would be more clearly aligned on general European interests and on the mutual benefit of Community policies.

On the other side, the opponents of an EU tax always point to the great significance for the course of integration that would be associated with such a measure.[19] Introducing an EU tax would be a fundamental step on the path to European statehood, because the granting of fiscal powers is a significant characteristic of a federal financial constitution. An autonomous own resource would furthermore automatically trigger a new round of centralization, because one decisive precondition for introducing an EU tax would be Europe-wide harmonization of national tax regimes. But precisely this potential centralization is rejected by the proponents of competitive federalism, who hold that only competition between the different territorial bodies creates incentives to limit the tax burden on individual citizens. Harmonizing or even centralizing the power to raise taxes would eliminate precisely that competition. This would lead, they say, to an inevitable softening of European budgetary discipline and to less efficient spending policies. The EU tax would therefore serve primarily to give the European Union new scope for spending without increasing the burden on the national budgets. Despite claims to the contrary by its advocates, opponents say the European taxpayer would have an additional tax to pay on top of existing national, regional, and local taxes, and the consequences of this development for the future of the integration process would be questionable. Simply because the costs of European integration were transparent and open for all its citizens need not necessarily mean that the European tax-payer would identify more strongly with the Union; on the contrary, this could actually further strengthen Euro-scepticism.

Hence, it will only be possible to implement an autonomous own resource for the EU if these arguments can be dispelled and in the long term both an increased burden on the taxpayer and an expansion of the EU Financial Framework can be excluded. The system must be transparent and comprehensible and the role and responsibility of national governments and the European Parliament in raising or lowering taxes must be clearly identifiable for the

[19] For a summary see Heinemann, F., *EU-Finanzreform 1999: Eine Synopse der politischen und wissenschaftlichen Diskussion und eine neue Reformkonzeption*, 35ff; Wissenschaftlicher Beirat beim Bundesministerium für Wirtschaft und Technologie, *Gutachten zur Neuordnung des Finanzierungssystems der Europäischen Gemeinschaft;* Faltlhauser, *Einführung einer „EU-Steuer?,* Caesar, Kein eigenes Besteuerungsrecht für die EU, in: Frankfurter Allgemeine Zeitung, March 28, 2006, and Caesar, *Probleme und Perspektiven der EU-Finanzwirtschaft*, 58–64.

taxpayer.[20] Given such publicity, the institutional interest of all the EU institutions in frugal budgeting and efficient use of funds would probably be greater. In the parliamentary debates over increasing taxes and spending, on the one hand, and tax reductions and efficiency increases on the other, those arguments that posit a potential European added value of joint measures and show that they are desirable and financially feasible should also gain more weight. This would shift the definition of European priorities to the center of the budget debates. The pressure to reform the EU budget would increase.

6. The Key Points of the Revision Process

In the rendez-vous clause of December 19, 2005, the Council of the European Union called on the European Commission "to undertake a full, wide ranging review," of how the EU funding system can be reformed and to present a report on this in 2008/09. On the basis of this report the Council will then "take decisions on all the subjects covered by the review," which are to be taken into account in the negotiations for the next Financial Perspective.[21]

It is already clear that the revision debate will touch on all dimensions and aspects of the EU funding system: revenues, spending, and institutional and procedural questions. The areas of reform are named and linked to one another in the European Council's conclusions:

1. The Common Agricultural Policy, whose financial restructuring basically amounts to a reorientation of current priorities in EU spending policy.
2. The UK budget rebate and the associated search for possible adaptations on the revenue side of the EU's financial constitution.

There is also a third major element in the reform discussion[22]: the European Commission announced early in the process that it will again be proposing the introduction of an autonomous source of revenue and successfully included these issues in the Council Decision on the new own resources system. This now includes an Article 9 which stipulates that, in its 2008/9 report, "the Commission shall undertake a general review of the own resources system."[23]

The timetable for the revision process is largely defined by the following considerations:

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[20] European Commission, Financing the European Union: Commission Report on the Operation of the Own Resources System, COM (2004) 505 final/2; Raddatz, Schick, *Braucht Europa eine Steuer?;* Becker, *Der EU-Finanzrahmen 2007–2013*.

[21] Council of the European Union, Note from Presidency to European Council, Subject: Financial Perspective 2007–2013, doc. 15915/05, December 19, 2005, items 79 and 80.

[22] Besides the issues already mentioned, there are other items on the revision agenda too, including synchronizing the terms of office of the European Parliament and Commission with the cycle of the Financial Perspective and the fundamental question of strengthening parliament's influence in drafting the EU Financial Framework.

[23] Council of the European Union, Own Resources Decision of 7 June 2007 (2007/436/EC, Euratom - OJ L 163, 23/06/2007)

a) The current Financial Framework runs until the end of 2013, giving the EU a secure legal and financial basis for the years 2007 to 2013. Negotiations on a new Financial Perspective will begin as usual with the publication of a communication by the Commission. In the new Interinstitutional Agreement the Commission agrees to publish this communication no later than July 1, 2011.

b) In its compromise of December 17, 2005, on the Financial Perspective, the European Council requests the Commission to present a report in 2008/09. The Commission indicated that this report will be published by end of 2008 or in the first half of 2009 – depending on the political climate in the course of the ratification of the new European treaties.

However, it is already becoming apparent that the discussion on the reform of the Financial Framework has already begun. The Commission has given the first indications with its consultation paper from September 2007 which will include a set of questions and comments intended to launch a structured public debate on the options for reform. This public consultation process will end in April next year and be followed in May 2008 by a conference of Commission and European Parliament structuring and covering all aspects of the financial framework, revenues and expenditure. The final report of the European Commission then shall “serve as the basis for structuring the subsequent revision process”.[24]

The European Parliament has also raised its voice at an early stage in this debate. On March 13, 2007, its rapporteur, Alain Lamassoure, presented a report on the future of the European Union’s own resources, which was adopted in Parliament on March 29, 2007, by a large majority.[25] It proposes a two-stage reform, with the first step being to abolish all exceptions and rebates by 2013 and to fund the EU budget through a uniform percentage of the gross national income of each member state. The second stage, starting in 2014, would introduce a system of genuine “own resources” for which the European parliamentarians propose the payment of a limited and clearly identifiable proportion of an existing national tax.[26]

In the negotiations over the new Interinstitutional Agreement, the European Parliament has already ensured that in the phase after the publication of the Commission’s report it will be “appropriately” included in the scope of “on the basis of the normal political dialogue between the institutions” and that the European Parliament’s positions will be “duly taken into

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[24] European Commission, Contribution to the Interinstitutional Negotiations on the Proposal for Renewal of the Interinstitutional Agreement on Budgetary Discipline and Improvement of the Budgetary Procedure, (working document) COM (2006) 75 final, February 15, 2006, 2.

[25] European Parliament resolution of 29 March 2007 on the future of the European Union’s own resources, P6_TA-Prov (2007)0098. Lamassoure sought direct contact with the national parliaments at an early stage of the preparations for his report, in the form of a questionnaire and through discussions with the national parliamentarians.

[26] In its resolution the European Parliament speaks of “the complete failure of the current system,” which is “unfair” and “anti-democratic.”

account."[27] If the European Council reaches concrete decisions in the further course of the revision process it must involve the Parliament "in accordance with the relevant procedures and in full respect of its established rights."

Thus in the stage of the revision process prior to the publication of the Commission's report Paper, the EU institutions - Commission and Parliament - will dominate the debate. They will attempt to focus the discussion on their goals, their political priorities, and their preferred reform options. For the member states, however, this division of roles in no way means that they can afford to be inactive. Rather, it is to be expected that especially those parties whose interests are directly affected by the revision process will work to influence the Commission's statement, either on the spending side or on the financing side of the EU budget. Just as the European Parliament has done through the Lamassoure report, the Commission and interested member states will also attempt to put their ideas and positions onto the reform agenda at an early stage.

The material range of the negotiating topics will be determined by two main factors:

1. The revision process will certainly not anticipate the negotiations on the future Financial Framework beginning 2014. So neither the volume of the budget nor the specific distribution of funds to the various budget headings and policy fields will be discussed. Those negotiations will not begin until 2011/12.
2. The participants in the reform debate are not in a position to attempt to modify the underlying treaties. This means some reform options are excluded, for example a transition to a generalized European financial compensation system between member states in the sense of a net fund model. This reform option would require the amendment of Article 158 (TEC), in which the regional dimension of European cohesion policy is firmly anchored.

Although the revision clause was fleshed out in the Interinstitutional Agreement and the emerging timeframe is relatively firm, the rest of the process remains unclear. A format for the negotiating process has not been specified, and no additional material key points — still less concrete targets for the planned comprehensive reform of the EU Financial Framework — have so far been stated. This very lack of definition opens up both opportunities and risks, because every influence exerted on the structure and course of the process can either introduce additional topics and set new accents, or - conversely - prematurely scupper efforts to concentrate on a realistic reform agenda.

[27] In the negotiations over the Interinstitutional Agreement the Council initially attempted to prevent MEPs being formally integrated in the process.

7. Potential New Influences

The European political environment will be decisive for the debate's structure and its prospects of success. The European Union is increasingly perceived as an actor on the stage of international politics, and called on to fill that role. As a result, the challenges faced by the EU are growing in tandem with the responsibilities and expectations placed upon it. If the Union is to adopt an active, policy-shaping role in the "globalised world,"[28] it must do more than develop institutionally; it also requires corresponding financial resources both for the common foreign, security, and defense policies and for fields such as promotion of innovation and research in the form of increased investment. The need for funds grows automatically as the tasks increase and new fields of policy become Europeanized.

Resuming the WTO Doha round - for which European agricultural policy proved to be one of the stumbling blocks - is without doubt of central importance for the revision of EU spending policy. If the European producers of agricultural products are, as desired, to remain competitive in global agricultural markets, then the CAP must continue its shift to direct income support for European farmers. Continuing, and indeed speeding up, the reform of the Common Agricultural Policy is a fundamental precondition for reviving or continuing the Doha round. In this way the WTO talks could yet again act as a catalyst for reforming the CAP.[29]

Alongside these challenges arising from global policy, to which the EU and its member states will have to find adequate responses, there are also decisions in the pipeline whose budgetary consequences the EU can determine for itself.

The most important fundamental decision for the further development of the EU Financial Framework will undoubtedly be the admission of new members.[30] The decision to start membership negotiations with Turkey is portentous in this connection because Turkish membership of the EU would add to the socioeconomic disparities within the Union. According to the European Commission, the magnitude of the burden of Turkish accession would be comparable to the effects of the admission of ten new members on May 1, 2004.[31] Simply increasing the volume of the EU's budget seems not to be a realistic option. For this reason

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28 European Commission, *European Values in the Globalised World*; see also European Commission, *Europe in the World–Some Practical Proposals for Greater Coherence, Effectiveness, and Visibility*.

29 Nedergaard, *The 2003 Reform of the Common Agricultural Policy*, 203–23.

30 European Parliament, Report on the Consequences of Future Enlargements on the Effectiveness of Cohesion Policy, rapporteur Markus Pieper, A6-0087/2007, March 28, 2007.

31 Estimates for the EU Structural Funds suggest annual costs of around €13,500 million; various studies put the annual cost for the CAP at more than €8,000 million. The European Commission's impact study of the possible implications for the CAP of Turkish EU membership came to the conclusion that after possible transitional periods lasting until 2025, the annual cost of full direct payments and market expenditure at today's prices (2004) could be €5,300 million and €660 million respectively, see European Commission, Issues Arising from Turkey's Membership Perspective, working document, Brussels, October 6, 2004, SEC (2004) 1202; see also Quaisser, Wood, *EU Member Turkey?*; similar Hughes, *Turkey and the European Union: Just Another Enlargement?*.

alone, the plans to admit Turkey should exert additional pressure for the reform of the EU's finances and budget.

The strongest effects on the revision process will certainly be those arising from the 2009 elections to the European Parliament and the subsequent appointment of a new European Commission. The European elections will redefine the composition of an important institution that has insisted - early and loudly - on a proper hearing and a "clearly defined role" in the reform process.[32] The appointment of the next Commission President is also closely tied to the outcome of this election and should respect the party-political allegiances and majority in the European Parliament. Because appointments at the European level are often tied to important policy decisions, this appointment - the EU's most important - could also become part of a broader overall package.

The European Parliament, however, can (and probably will) use the appointment hearings of the new commissioners in the second half of 2009 to commit the incoming Commission to the Parliament's position on the revision of the Financial Framework. Accordingly, the nomination of the next President of the European Commission and the composition of the Commission – will coincide with the discussion of reform of the EU's financial constitution. And the European Parliament will have to two agree to these important personnel appointments and link its assent with policy issues.

8. Conclusion

The wording of the revision clause is extremely vague, not naming any key points or setting any objectives for the in-depth overhaul of the EU Financial Framework. The vagueness of the clause and the fact that the current Financial Framework guarantees a solid legal and financial basis for the years 2007 to 2013 imply that the revision debate can oscillate between fundamental political discussions over the principal goals and tasks of the expanded Union at one extreme and concrete proposals for adapting the political and budgetary priorities to the new challenges at the other. This may occur without these proposals being expressed in precisely calculated budgetary terms and without the fundamental debate manifesting itself in specific formulations for adapting European primary law. In a best case scenario, the EU will use the revision clause to discuss new principles, targets, and structures, to agree upon them unanimously, and then give the necessary political weight by a decision of the European Council, so that the revision can then be implemented in the course of the actual 2011/12 funding negotiations. In this way, at the end of the revision process there should be a decision of the European heads of state and government

[32] European Parliament, Committee on Budgets, Working Document No. 3 on Financial Perspective 2007–2013: EP Key Points for the Negotiations with the Council Based on the European Parliament's Negotiating Position of 8 June 2005, PE 367.953v01-00, January 26, 2006.

containing the most specific possible requests to the Commission and the ministerial configurations of the Council, differentiated by policy field and specifying material and financial goals for reform of individual areas of policy.

Using the revision clause to reform the EU's financial constitution depends on the common will of all participants to overcome the *status quo.* All EU-organs and member states should agree that the goal of reform must be to bring about a clear shift in the priorities of EU spending policy to allocative policies and on the revenue side to give the EU greater autonomy. In the medium term the multi-annual Financial Perspective could then be developed into an integration policy planning instrument where political priorities are given concrete financial backing. This ambitious reform project can only become reality if all member states are willing to adapt the EU's financial constitution and the Union as a whole to the new conditions and challenges of the globalised world. A deliberate revision debate orientated around this goal offers a framework to discuss the tasks of the EU budget away from the limelight of media attention and the focus on national net balances.

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