Friedrich Naumann STIFTUNG FÜR DIE FREIHEIT
STIFTUNG Marktwirtschaft

Conference Report

A New Financial Constitution for the EU

Perspectives for the 2008/2009 Budget Review

Prof. Dr. Karl-Heinz Paqué, Prof. Dr. Manfred J.M. Neumann, Dr. Dalia Grybauskaitė, Petra Pinzler, Dr. Silvana Koch-Mehrin, Prof. Dr. Michael Eilfort and Prof. Daniel Gros, Ph.D. (left to right).

Contributions

2 Prof. Dr. Michael Eilfort
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3 Dr. Dalia Grybauskaitė
European Commissioner for Financial Programming and Budget

4 Dr. Silvana Koch-Mehrin
Deputy-Leader of the ALDE Group in the European Parliament

6 Prof. Daniel Gros, Ph.D.
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7 Prof. Dr. Manfred J.M. Neumann
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8 Prof. Dr. Karl-Heinz Paqué
Chairman of the liberal group of the state parliament in Saxony-Anhalt, University of Magdeburg

In autumn 2007, the European Commission launched the review process of the European budget. This review process had been agreed upon by the EU member states and the European Parliament negotiating the multi-annual financial framework 2007–2013. By 2009, the Commission intends to present a budget reform proposal which will be used as a basis for further discussions with EU institutions and member states.

Although experts have long criticized the current budget structure – both the expenditure and the revenue side – as inefficient, not transparent and not in line with the political goals of the European Union, very little progress towards a modern budget has been made in the past. The EU budget still primarily reflects “historic” priorities of the EU.

It is evident that a fundamental reform of the European financial constitution is not an easy task. Pressure groups and national interests – real and imaginary – have often prevented major breakthroughs in the past and have lead to continuing tension among the member states. But without fundamental changes, the EU will neither be capable of reaching its economic and political targets nor be able to give new momentum to the European integration process. A successful budget reform seems to be vital for Europe’s future.

In order to provide productive input to the ongoing discussion process, the Friedrich-Naumann-Stiftung für die Freiheit and the Stiftung Marktwirtschaft (Market Economy Foundation) jointly organised the “A New Financial Constitution for the EU – Perspectives for the 2008/09 Budget Review” conference. Well-known experts discussed key issues and requirements needed in order to improve the EU budget. The discussion was chaired by Petra Pinzler, of the German weekly newspaper “Die Zeit”.

Welcome

In his welcoming speech, Prof. Dr. Michael Eilfort, director of Stiftung Marktwirtschaft, pointed out that the European integration process had faced some “headwind” in the past – culminating in the rejection of the “European Constitution” by two member states. To him, therefore, the adoption of the Treaty of Lisbon, which still had to be ratified by a number of member states, was a positive signal for Europe since it gave new hope for ending the “institutional sclerosis” following the failure of the constitution. An agreement on a new legislative basis for the European Union would give fresh impetus for finding an effective solution for the next important institutional task: the reform of the European budget. According to Eilfort, the current EU budget contributes far too little to an economically prosperous and dynamic future for Europe.

On the expenditure side, he criticized not only the anachronistic priorities in the budget, but also the fact that, from an economic point of view, many fields of expenditure do not belong on the European level. Regarding the revenue side, he made it clear that neither the current system of so called “own resources” nor a power to tax for the EU are convincing solutions. While the system of own resources easily leads to paralysing discussions over net payment positions and budgetary correction mechanisms, a European tax has also severe drawbacks: not only is it very hard to find a sufficiently harmonised tax base broad enough to capture most European citizens, but there are also well-grounded concerns that, due to the current institutional set-up on the European level, an EU tax would increase the overall fiscal burden for its citizens.

Eilfort concluded that after years of pragmatic compromises and muddling through regarding EU finances, a real breakthrough in the European budget was overdue in order to make Europe fit for the future.

Dr. Jürgen Wickert (Friedrich-Naumann-Stiftung für die Freiheit) and Prof. Michael Eilfort (Stiftung Marktwirtschaft) welcome EU Commissioner Dr. Dalia Grybauskaitė.

Reforming the Budget – Changing Europe

Dr. Dalia Grybauskaitė

European Commissioner
for Financial Programming and Budget

Commissioner for Financial Programming and Budget, Dr. Dalia Grybauskaitė, was fairly optimistic that – in contrast to past experience – a fundamental reform of the European budget in the coming years might be possible. She emphasized that at the moment there is a historic chance for this, since all member states and the European Parliament have agreed to examine the existing budget and to undertake a full, wide-ranging review which covers all aspects of EU spending, including the Common Agricultural Policy (CAP), and of EU resources, including the UK rebate. Accordingly, the Commission started this evaluation process in the second half of 2007, inviting all interested parties to take part in an open debate on EU finances without any "taboos", and intends to present a proposal for reform by the end of 2008.

Grybauskaitė emphasized that there are enormous pressures on Europe to reform its financial constitution – resulting both from new challenges such as globalisation, terrorism, the environment and immigration and from preparing the European Union for further enlargement. In her opinion, today's structure of the European budget was neither future-oriented nor particularly efficient. By 2013, the EU will spend around 80% of its budget for only two policies – agriculture and structural operations; something which was agreed upon in the middle of the last century and has not been reformed much since then; thus they are far removed from the necessities and new challenges the EU faces today.

Policy reforms first

Since every budget is only a reflection of politics, the Commissioner pointed out that Europe needed a discussion about its future political priorities. If policies have no clear focus, budgets will be in a mess. According to her, the budget reform should be policy-driven and based on long-term considerations. New risks and challenges as well as an analysis of the potential added value of European spending has to be taken into account when answering the question: what policies are supposed to be financed by European money in the long run? With regard to the member states, she called for bringing the ambitious political reform rhetoric and the disenchanting reality of economic and financial negotiations in line. This has so far been mostly dominated by debates on "juste-retour", with the member states attempting to maximize their self-interest.

The self-evident, long-term persistence of the current, ill-suited budget structure was criticized by Grybauskaitė with the words: "If man has made these rules, man can also change them". The Commissioner pointed out that long-term policy changes which only become effective in the distant future should be a lot easier for national governments to agree upon. In contrast, given the unanimity principle and an enlarged Europe, radical short-term changes seem to be basically impossible; therefore, the core elements of budget reform would not aim at the present or the next multi-annual financial framework with its precise amounts of money, but for a separate, more visionary exercise.

Apart from the discussion on the long-term policy goals of the European Union, Grybauskaitė also pointed out that there is a need for efficient delivering mechanisms in order to reach the targets aspired to. Again she did not want to impose ready-made solutions, but to point out some of the issues that should be discussed such as transparency and accountability of the budget; the question of co-financing; and the



optimal degree of flexibility in EU spending. She was very satisfied that a significant step towards more transparency had already been made: by 2009 there will be transparent information on all beneficiaries of European funds – including agricultural beneficiaries. In her opinion, more transparency is essential for faster reforms in the budget, because only then can people evaluate the money flows from the EU.

Discussing the financial resources of the EU, Grybauskaitė underlined that in relation to Gross National Income (GNI) and although additional tasks and challenges have emerged, the European budget has diminished in recent years. At the moment it lies below 1% of GNI. She argued that this relatively small amount might be enough if it were spent efficiently on only new projects with a high added value for Europe. But reality was different due to inefficiencies and ill-suited policies.

"Today we are spending and losing a lot" was her conclusion. The European budget, instead of being a tool for policy realisation, had become an instrument for redistribution between the member states, who – with the argument of "juste-retour" – tried to get as much money back as possible, either via the spending side or via corrections on the resource side; therefore a promising proposal for budget reform had to include three packages: priorities, delivery instruments and resources.

A Better Fiscal Constitution for Europe? Requirements and Outlook

Dr. Silvana Koch-Mehrin

Deputy-Leader of the ALDE Group in the European Parliament

Dr. Silvana Koch-Mehrin MEP, Deputy Leader of the ALDE Group in the European Parliament, was more critical than Commissioner Grybauskaitė regarding the perspectives for a successful reform of the European budget. In her view, the pressure to change the European budget has increased in the recent past, but would not lead to substantial results. Despite the tremendous changes in the EU in the past decades, like the EU enlargement process, the realisation of the internal market or the monetary union, the budget has re-

mained more or less unchanged. She concluded that the current budget structure does not reflect the necessary policy priorities. The potential to change this situation towards a real reform would be not very likely.

Missed opportunities

Koch-Mehrin criticized that the small changes in the budget since the late 1980s had been mainly cosmetic without any substantial improvement. For example, the budget item "Structural Operations" had been renamed "Cohesion for Growth and Employment" without any policy change. In addition, the UK rebate had not been addressed offensively enough during the last negotiations on the present financial framework. Instead, additional financial corrections for other member states had more or less arbitrarily been introduced.

Despite the criticism with regard to a fundamental budgetary reform, Koch-Mehrin also identified some encouraging signals for future improvements. First, she referred to the transparency initiative, which would publish beneficiaries of EU funds. Second, there had been a general agreement between member states that the frustrating negotiations on the current financial framework, which had resulted in a bad compromise, should not be repeated. And third, there was a broad agreement that the current budget with its large share of agricultural and structural operations mainly was a historic relict. Less than 25% of the budget is currently used for new policy priorities. But, as Koch-Mehrin pointed out, this general discontent with the budget does not automatically lead to consistent, clear cut conclusions or reform proposals.

Regarding the revenue side she emphasized, that a budget volume of about 1% of Gross National Income (GNI) seems to be small in comparison to national budgets of the member states. But one must not forget that the EU's financial obligations are also much smaller. For example, the budgets on social and health programmes in the member states are fundamentally larger than in the EU. In order to bring an end to the "juste-retour" debate, i.e. the focus of member states in negotiations on what share they receive from the EU budget, Koch-Mehrin called for a transparent, fair and easy-to-handle revenue method. She proposed a 1% share of national GNI as a fair burden for each member state including the traditional own resources. The VAT resource (based on the VALUE ADDIT TAX) as well as all current rebates and special rules for some member states should be abolished. On the other hand, a more extensive reform of the revenue side, e.g. a special tax competence for the EU, was strongly rejected by Koch-Mehrin. Since the European Parliament does not have complete budgetary powers, an EU-tax was not justified. "There must not be taxation without representation", emphasized Koch-Mehrin. Regarding the expenditure side, Koch-Mehrin made several reform proposals on how to bring the budget in line with political priorities,

especially those defined in the Lisbon-Agenda. The natural starting point was the Common Agricultural Policy. A major step forward would be introducing obligatory national co-financing in CAP. This principle, which is relevant for most other areas of EU spending, would significantly change the incentives for budget negotiations. Another improvement would be a time limit for structural funds and a degressive funding-mechanism. EU spending should be focused on creating European added value.

The discussion was chaired by Petra Pinzler, *Die Zeit*.

A Better Budget for Europe: Are We on the Right Track?

Prof. Daniel Gros, Ph.D.

Centre for European Policy Studies

Prof. Daniel Gros, Director of the Centre for European Policy Studies, agreed with the previous speakers that the European budget does not reflect the main tasks and policy goals of the European Union. “In a nutshell, the problem is that we spend too much on agriculture.” With different spending priorities, there would be no UK rebate because most agricultural support is outside the UK; therefore the central reform for the EU budget should be cutting down agricultural spending – and Gros emphasized that everybody has known that for quite some time.

But why is there this strong bias to perpetuate the historically arisen budget structure instead of adapting it to current needs? According to Gros, it is the decision-making structure for the EU budget which not only favours national interests, but also the status quo: the spending priorities of the EU – embodied in the multi-annual financial perspective – are de facto determined by the Council, where national representatives and national interests are at work. In these negotiations, no one defends the overall EU interest; therefore it was no wonder that the principle of “juste-retour” dominates. Moreover, a strong status quo bias was at work since the old budget would continue if there was no agreement on a new one; and due to the unanimity rule, nothing could be changed without buying everybody off. Therefore the European Parliament is restricted to making only small changes in the annual budgets. Like decorating a Christmas tree, the Parliament could only ad small projects, but not change the overall design of the budget, stressed Gros.

Reform of the Decision-Structure

In order to produce a better European budget, the decisions on spending priorities should be given to a body which has the overall EU interest in mind. According to Gros, this should in principle be the European Parliament. For example, he could imagine a situation where the Council would still decide on the overall spending limit as a percentage of GNI, e.g. 1.0% or 1.2%, but within this ceiling the decisions on spending priorities would be left completely to the European Parliament. With extended responsibilities, there was the hope that the Parliament would bring the budget structure in line with the political goals of the EU. Unfortunately, the last good occasion to change the decision-making structure of the EU and to foster change was the last enlargement round which had been passed up. The Parliament especially could have objected and vetoed the inter-institutional agreement and insisted on reforms, but did not do so. At that point, due to the enlargement, there had been no credible threat that the Council would continue with the existing budget if an agreement failed to emerge.

Regarding future reforms of the budget, Gros was fairly pessimistic. Until 2013, the existing multi-annual financial framework has to be lived with. Regarding the years following, he expected change only if there were significant improvements in the decision making process of the European Union. Unfortunately in this respect, the Treaty of Lisbon would only change things marginally and in an ambiguous way: the multi-annual financial framework will become a Council regulation, codifying the minimal role of the European Parliament and thus even strengthening the status quo. On the other hand, one small improvement might be the potential use of the so-called Passerelle Clause: this would give the European Council the possibility to unanimously decide that future decisions by the Council regarding the multi-annual financial framework could be agreed upon by qualified majority voting instead of requiring unanimity, and thereby diminishing the status quo. If the Passerelle Clause was in force, it might lead to some changes in the budget structure. Without it, Gros predicted that even in the long-run things would not improve.

The System of Own Resources: Should We Improve or Abandon It?

Starting his presentation, Prof. Dr. Manfred Neumann reminded the audience that – from an economic point of view – the central task of the European Union was providing European public goods and, most importantly, the 4 freedoms, i.e. the free movement of people, goods, services and capital in the internal market. These public goods had to be provided by the state, but would not cost very much. Most of the current spending went to other things which were not congruent with European interests, but instead national ones. Neumann emphasized that from a narrow, national point of view, it was attractive to maximize the monetary flow from the EU, once you had decided how big the European budget is – for example 1% of Gross National Income (GNI); therefore, member states would have an interest to increase spending for agricultural policy or cohesion policies. In 2007 the largest part of the total budget of 128 billion Euro was still reserved for these two policy fields, although – according to Neumann – the EU did not need them due to their inefficacy.

Turning to the revenue side, Neumann briefly described the current system of own resources. It consists of the so-called "traditional" own resources (TOR), i.e. import duties and agricultural levies, the VAT based resource and the GNI based resource. He stressed that the latter two should be called fiscal contributions by the member states instead of "own resources", since they are paid from national tax revenue. He also severely criticised the existing correction mechanisms in the budget and stressed that the historic motivation for the UK rebate, the low return from the Common Agricultural Policy to the UK, had become much less convincing compared to the situation leading to its introduction in 1984. Since that time, parts of the correction mechanism had been supplemented and extended to other member states, leading to a crazy system, argued Neumann.

A reform proposal

In view of these deficits in the current budgetary system of the European Union, he made the following reform proposal: first he advocated the complete abolishment of all rebates; otherwise, policies would open the doors for extended rebates and all types of questionable political negotiations. He singled out the Fontainebleau agreement, which dates back to 1984 and states that "any member state sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time".

In order to finance the budget, he proposed a combination of the traditional own resources with a transparent system of contributions. In principle, these could either be based on GNI or VAT, but should also depend to a smaller extent on the voting rights of the member states in the Council. Although Neumann preferred contributions based on GNI, since the Gross National Income is a popular indicator for the ability to pay, he cautioned not to condemn contributions on a VAT base. They would merely represent a different criterion as the VAT base was a good indicator for the ability to consume. More important to him was the recommendation that the financial contributions should also be based to a small degree on the voting rights of the member states. He stressed that voting rights are not strictly proportional to the population size, but rise at a diminishing scale, which implies that smaller countries hold more than proportional voting power. If his proposal became reality, smaller countries would have to pay more. As a last element, he proposed a 10% cut in the EU budget. Neumann claimed that this should be within the realms of possibility.

Prof. Dr. Manfred J.M. Neumann

University of Bonn, Kronberger Kreis

Analysing the financial impact of his proposal, Neumann showed that the abolishment of the UK rebate and a combination of traditional own resources with only GNI based financial contributions would make every member state better off, except the UK. Things would look different if 10% of the financial contributions were based on voting rights. In this case, a large number of smaller countries would be effected negatively. Allowing for the 10 % cut in the EU budget, this negative effect from the introduction of voting rights would be reduced to some degree.

Conclusion

Prof. Dr. Karl-Heinz Paqué

Chairman of the liberal group of the state parliament in Saxony-Anhalt, University of Magdeburg

Although he agreed with the previous speakers regarding the big reform necessities for the EU budget, Prof. Dr. Karl-Heinz Paqué, Chairman of the liberal caucus of the state parliament in Saxony-Anhalt, University of Magdeburg, was much more optimistic that this goal could be achieved in the middle and the long-term. He pointed out that real world politics are not solely a matter of narrow-minded interests, but also of general ideas and visions and – not least – public pressure. Therefore he did not want to believe that a complete change of the ill-suited decision-making structure of the EU – as Prof. Daniel Gros had advocated – was an indispensable requirement for reforming the budget. As an example, he referred to the fall of Communism two decades earlier: in the 1980s, all experts basically argued that Communism in eastern Europe would never fall and those in power would never give way. Yet only a few years later things changed dramatically, not because the constitutional setting had changed in these countries, but because the public pressure for freedom and economic prosperity had dramatically increased.

Regarding the European Union, Paqué saw a chance that increasing public pressure could force a change in the Common Agriculture Policy, which in his opinion is the core of the problem. Rising world market prices for agricultural products might facilitate a policy change; moreover, unlike the 1950s and 1960s, the EU no longer stands for coal, steel and agriculture, but science, education and future-oriented technologies. Also, the share of agriculture-based expenditure in the EU budget had declined from around 80% in the early 1980s to 40 %; therefore, at least in the longer term, he saw an opportunity for a turn for the better. As a first step, Paqué supported the idea of introducing co-financing to the Common Agricultural Policy. Although co-financing still contains incentives to waste money, it would be a major step-forward.

In contrast to the CAP, Paqué was less sceptical regarding cohesion policy: “We do not know if it helps, but at least the money did not hurt” was how he summed up its track record. Moreover it may have served as a political lubricant in some countries to overcome political resistance against other important reforms.

With respect to future development of the EU, Paqué emphasized two aspects: first – regarding the expenditure side – the principle of subsidiarity had not to be forgotten when thinking about future priorities of the European Union. And second – regarding the revenue side – he reminded the audience that justice is closely linked to simplicity – “What you do not understand, you think is unfair” – therefore a simple, easy to understand revenue system should be of high priority.

Publishing details

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The conference took place in Brussels, October 10th, 2007.