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# Budgetary Policy of the European Communities: Squaring the Circle

by Gerhard Stahl, Brussels\*

**The EC's budgetary problems are coming to a head. For 1983 virtually all the Community's resources have been utilized, and there are growing fears that the Community will soon have to declare itself bankrupt unless changes are made to current policy. What should be done to secure the financing of Community policies taking account of the additional financial requirements resulting from the impending accession of Spain and Portugal?**

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The European Community's discussions on the budget have entered a crucial phase. On 10 June 1983, the Commission submitted its preliminary draft for the coming financial year and the Council used this as a basis for the first reading of the draft budget for 1984. It soon became clear that these discussions will be fraught with all kinds of tensions and difficulties. The main episodes of the budget saga have been apparent for some time, even to the most casual observer of European policy:

- a sharp increase in agricultural expenditure creates a need for additional budget appropriations and brings the discussions back to the reform of the Common Agricultural Policy;
- the debate on the amount and implementation of the refunds to the United Kingdom once again heads the agenda;
- the weaker Community countries call for financial solidarity. They insist that budgetary policy must include more measures to reduce economic disparities. The "richer" countries on the other hand insist on a policy of austerity;
- disputes between the Council and the European Parliament over the key areas of European budgetary policy lead to renewed fears over institutional conflicts.

These familiar problems are being overshadowed by the fear, which is almost a certainty, that the European Community will have to declare itself bankrupt in the next few months unless changes are made to current

policy. The foreseeable financial limits were the main talking point at the meeting of the European Council held in Stuttgart in June.

The financial paralysis of the Community was easy enough to predict. Both the European Parliament and the Commission have for many years been drawing attention to the need to reform the budgetary policy and the system of revenue<sup>1</sup>.

## Budgetary Policy over the Past Few Years

A few details on European budgetary policy over the past few years might be useful in understanding the current discussions. Table 1 shows that the development of agricultural expenditure is of crucial importance for the Community budget. However, the Community succeeded in reducing agricultural expenditure substantially from 1979 to 1982.

This was primarily the result of favourable conditions on the world market in agricultural products rather than the success of structural reforms of the Common Agricultural Policy. Substantial amounts of additional expenditure authorized during the current year – which have created the need for a supplementary budget – indicate that it has not been possible to make a lasting reduction in the threat to the internal cohesion of the

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<sup>1</sup> In November 1978, the Commission submitted a communication to the Council and Parliament entitled "Financing the Community: the way ahead" (COM(78) 531 final). The European Parliament set up a working party in 1979 and in January 1981 it drew up a report on the Community's own resources (Doc. 1-772/80) which was adopted by the European Parliament. On the need for budgetary reform see also Gerhard Stahl: Die Gemeinschaft an der Grenze der finanziellen Handlungsfähigkeit, in: WIRTSCHAFTSDIENST, Vol. 60 (1980), No. 11, p. 535 ff.

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budgetary policy posed by the Common Agricultural Policy in the last few years<sup>2</sup>.

The Community's other activities continue to occupy a position of secondary financial importance in comparison with the Common Agricultural Policy. The share of structural policy and development aid has increased only slightly from 14.09 % to 16.21 % between 1979 and 1982<sup>3</sup>. At 22.43 % the prospects for 1983 look far brighter but this is due to the fact that a large part of the refunds paid to the United Kingdom in 1983 is to be covered by additional structural policy programmes. In view of the considerable importance generally attached to the structural policy for the maintenance and further development of the Community, it is impossible to express satisfaction with this budgetary structure despite the improvements which have been made<sup>4</sup>.

### Development of Revenue

It is a well-known fact that the Community is largely financed from its own resources, i. e. essentially from own resources accruing from VAT, customs duties and

<sup>2</sup> It is interesting to note that the greater part of agricultural expenditure relates to a small number of products. Dairy products (30.4% of total expenditure in 1981), cereals and rice (17.8%) and beef, veal and pigmeat (14.5%) account for more than 60% of total expenditure under the EAGGF Guarantee Section.

<sup>3</sup> This is the sum total of the amounts allocated to social, regional, research, energy, transport and development policies.

agricultural levies. VAT is particularly important for the financing of the Community. It accounts for roughly 50 % of total revenue and is therefore the Community's largest single source of income. In addition, where revenue accruing from VAT is concerned, the Community can utilize this tax up to a maximum of 1 % of a universally agreed basis of assessment.

Table 2 shows how an increase in Community expenditure has been reflected in increasing demands on own resources. The 1983 rate indicates that virtually all the Community's own resources for 1983 have been utilized<sup>5</sup>.

The draft budget for 1984 is also based on the utilization of virtually all revenue. According to the document adopted by the Council on 22 July following the first reading, the rate of utilization of own resources accruing from VAT is 98.6 %<sup>6</sup>. If we bear in mind that it was impossible at that stage to allow for the impact of the farm prices for 1984 which have yet to be fixed and

<sup>4</sup> For further details of the criticism of the existing budget structure see the Commission report of 30 May 1980, 24 June 1981 (COM(81) 300 final); the report of the Committee on Economic and Monetary Affairs on the Commission report on the mandate of 30 May 1980, 4 June 1982 (Doc. 1-307/82); Angela Noitelmann: Der Haushalt der Europäischen Gemeinschaft, Probleme und Reformvorstellungen, Hamburg 1982, p. 72 ff.

<sup>5</sup> This rate includes supplementary budget No. 2 for 1983 in the form adopted by the Council following the first reading.

<sup>6</sup> This includes Parliament's margin for manoeuvre on subsequent budget discussions pursuant to the Treaties.

**Table 1**  
**Development of Expenditure 1979-1983 (payment appropriations)**

	1979		1980		1981		1982		1983	
	in million ECU <sup>1</sup>	in %	in million ECU	in %	in million ECU	in %	in million ECU	in %	in million ECU	in %
EAGGF Guarantee	10,384.1	71.88	11,485.5	70.97	11,580.0	62.82	13,671.3	62.19	14,050.0	61.36 (63.3) <sup>2</sup>
Fisheries	46.7	0.32	64.1	0.40	53.5	0.29	87.6	0.40	84.4	0.37
Agricultural structures	334.3	2.31	328.7	2.03	531.8	2.88	773.6	3.52	651.2	2.84
Regional policy	699.0	4.84	603.0	3.73	1,022.9	5.55	1,293.8	5.89	1,485.8	6.49
Social policy	551.9	3.82	768.8	4.75	732.8	3.98	1,022.3	4.65	1,475.1	6.44
Research, Energy, Industrie, Transport	288.0	1.99	379.5	2.35	313.9	1.70	435.7	1.98	1,198.3	5.23
Development cooperation and cooperation with third countries	497.5	3.44	641.6	3.96	795.7	4.32	816.8	3.72	977.5	4.27
Allowances and refunds for Member States	771.5	5.41	852.8	5.27	1,443.1	7.83	1,125.9	5.12	1,128.3	4.93
Additional measures for the United Kingdom	—	—	119.7	0.74	925.1	5.02	1,654.2	7.52	692.0	3.02
Administrative appropriations:										
Commission	584.6	4.05	618.1	3.82	682.7	3.70	728.7	3.31	748.6	3.27
other Institutions	279.3	1.93	320.7	1.98	352.7	1.91	374.5	1.70	404.8	1.78
Total	14,447.0	100	16,182.5	100	18,434.0	100	21,984.4	100	22,896.0	100

<sup>1</sup> 1 ECU = approx. DM 2.30.

<sup>2</sup> Including draft supplementary budget No. 2/1983.

Source: Commission of the European Communities.

**Table 2**  
**Development of the Rate of Utilization of**  
**Own Resources Accruing from VAT**

Year	Utilization of VAT
1979	0.789
1980	0.732
1981	0.787
1982	0.925
1983	0.994 (incl. draft supp. budget No. 2)

Source: Commission of the European Communities.

that agricultural expenditure is subject to fluctuations caused by the quality of harvests and by conditions on the world market, there are serious doubts as to whether these allocations can be financed. Thus the demand for additional revenue and/or savings achieved by a reform of the Community policy has already become the key issue in the current budget discussions.

#### Attitude of the European Parliament

It seems appropriate to give a brief summary of the decisions taken so far by the Council and Parliament on the central issues of budgetary reform and the demand for new revenue as these two institutions together form the budgetary authority of the Community under a complicated decision-making procedure<sup>7</sup>. It is also necessary to look in greater detail at the decision-making bodies because the vital programme of budgetary reform has been delayed not by a lack of proposals for reform but by difficulties in reaching decisions.

Since its election by direct suffrage, the European Parliament has repeated its demand for the reform of the budgetary policy in numerous resolutions. It has stressed that the reform of the Community's system of revenue must be included in the overall reform of the budgetary policy. In its resolution on the draft general budget for 1980 it stated that it

□ "considers that a provisional decision to raise, by a small amount, the VAT ceiling, could be achieved during the 1980 financial year . . .

□ recognizes, however, that such an increase could only be justified politically in the context of curtailing agricultural expenditure which would otherwise threaten to absorb all increases in the Community's own resources, thus worsening the imbalance existing within the budget; considers further that the efficiency of other

Community financial instruments should be scrutinized in order to avoid overlapping and waste".<sup>8</sup>

The resolution on the Community's own resources referred to above presents this position in greater detail and at greater length. In this resolution, the European Parliament calls for an increase in the 1 % VAT ceiling and repeats its demand for the reform of the Common Agricultural Policy.

In the longer term, it calls for a more thorough redistribution of revenue in favour of the economically weaker Member States to be achieved by a gradual increase in revenue from VAT and by revenue equalization measures. The European Parliament referred to the problem of the United Kingdom, in this general context, as an unreasonable burden on the European budgetary policy.

In its opinion on the modification of the financial mechanism in favour of the United Kingdom the European Parliament "urges that the appropriate budgetary reforms be carried out before 1982 to make any continuation of the financial mechanism – even in a revised form – unnecessary".<sup>9</sup>

In December 1982, Parliament reiterated its demands for reform with determination by rejecting the supplementary budget No. 1/82 (compensation for the United Kingdom for 1982). It stated that it was "strongly critical of the Commission not only for having failed to exercise its right and duty to submit specific legislative acts designed to bring about a lasting solution to the budgetary imbalance but also for continuing to seek transitional solutions once again for the next three-year period."<sup>10</sup>

This idea of reform was also the guideline for individual decisions forming part of the budgetary procedure. The European Parliament's rapporteur on the 1983 budget, Mr Robert Jackson, carried out a quantitative analysis of Parliament's budgetary decisions from 1977 to 1982 and established the following priorities for Parliament:<sup>11</sup>

□ Restructuring of agricultural policy (This reflected in the budgetary procedure in the form of proposals for curtailing agricultural expenditure which recur every year. Since these have been classified as compulsory expenditure, however, the final decision on total agricultural expenditure is taken by the Council.)

<sup>9</sup> OJ No. C 311 of 30 November 1981.

<sup>10</sup> OJ No. C 13 of 17 January 1983, p. 36.

<sup>11</sup> Robert Jackson: The European Parliament's budgetary priorities, Working Paper No. 1 of the Committee on Budgets of 10 February 1982.

<sup>7</sup> For further details see Article 203 of the EEC Treaty.

<sup>8</sup> OJ No. C 302 of 3 December 1979, p. 41.

□ Extension of structural policy, particularly by increasing the appropriations earmarked for the Social and Regional Funds and for energy policy and aid to the developing countries.

### Decisions by the Council

The Council has considered the demands for budgetary reform on many occasions. The following section therefore contains only the most important of the decisions taken.

On 30 May 1980, the heads of government gave the Commission the task of formulating proposals for the reform of the Community budget before the end of June 1981. The starting point of this mandate was the unacceptable financial burden placed on the United Kingdom by the Community budget. The political crisis which arose as a result was settled by means of the agreements of 30 May.

This "Brussels Compromise" laid down the following points:<sup>12</sup>

- a reduction in the United Kingdom's net contribution for the 1980 and 1981 financial years;
- attention was drawn once again to the fact that the rate of increase in agricultural expenditure must be reduced so that the 1% VAT ceiling would not be exceeded;
- the Commission was formally instructed to draw up possible solutions for the structural problems of the budget before the end of June 1981 (this was the Commission mandate).

This mandate was rephrased as follows: "The examination will concern the development of Community policies, without calling into question the common financial responsibility for these policies, which are financed from the Community's own resources, or the basic principles of the common agricultural policy.

Taking account of the situations and interests of all Member States, this examination will aim to prevent the recurrence of unacceptable situation for any of them. If

this is not achieved, the Commission will make proposals along the lines of the 1980-81 solution and the Council will act accordingly."<sup>13</sup>

In 1981 the Commission submitted its proposals for the reform of Community policy. However, it proved impossible in subsequent negotiations to reach agreement on any substantial changes in Community policy. A clash of interests between the Member States on the role of the Common Agricultural Policy proved to be a major obstacle to progress on budgetary reform. The European Council, meeting in Stuttgart from 17 to 19 June 1983, was therefore compelled to place the Community's budgetary policy high on its agenda.

The European Council reached the following agreement on matters relating to the budget and finance:

- "The European Council agreed on compensation for the United Kingdom for 1983."
- "In the course of the coming six months major negotiations will take place to tackle the most pressing problems facing the Community. . ."
- "The negotiations will aim at examining all the existing policies with particular attention to the Common Agricultural Policy."
- "The aim is to secure the financing of Community policies . . . taking account of the additional financial requirements resulting from the accession of Spain and Portugal. . ."
- "On the basis of the conclusions reached . . . the extent and timing of the Community's requirements in terms of own resources will be determined."
- "The results of the negotiations will be submitted to the European Council meeting in Athens on 6 December 1983."<sup>14</sup>

<sup>12</sup> Other compromise agreements were adopted on matters such as fisheries and farm prices, etc.

<sup>13</sup> EC Bulletin 5-1980, paragraph 1.1.7.

<sup>14</sup> Conclusions of the European Council, printed in the EP Bulletin No. 26 of 28 June 1983.

## KONJUNKTUR VON MORGEN

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This resumé shows that the meeting in Stuttgart failed to achieve a breakthrough and that individual decisions were postponed until the Athens Summit Conference and beyond. The decision on the Commission's proposal of 6 May 1983 to increase the Community's own resources was also postponed.<sup>15</sup>

### First Reading of the 1984 Budget

The first reading of the 1984 budget by the Council of Finance Ministers of 20 to 22 July 1983 and the corresponding discussions on a supplementary budget No. 2 for 1983 were severely hampered by the fact that no fundamental decisions had been taken on basic questions relating to the budget and to finance.

The deliberations, which lasted almost thirty hours, were chiefly concerned with matters relating to finance. In order to avoid exceeding the 1% VAT ceiling, the revenue estimates for 1984 were examined in great detail and revised downwards. Substantial cuts were also made to the Commission's proposals particularly in the case of the European Social and Regional Funds. Proposals for curtailing expenditure under the Common Agricultural Policy failed to obtain a majority despite the call made at the Stuttgart Summit Conference for an examination of the agricultural policy.

Even if these changes are taken into account, the document adopted by the Council still gives rise to fears that revenue will not be sufficient to finance budgetary expenditure in 1984.

### Problems Affecting Budget Discussions

The fact that basic decisions on the reform of budgetary and agricultural policy and changes in the system of revenue were postponed at the Stuttgart Summit Conference until December 1983 has made discussions on the draft budget for 1984 very difficult. According to the deadlines laid down in the EEC Treaty, the annual budget discussions should be completed in December with the second reading in Parliament and the fixing of revenue and expenditure by the President of the European Parliament<sup>16</sup>. In order to comply with this schedule and adopt a draft budget for 1984 which can be used as an official basis, we need to know which decisions will be taken at the Summit Conference in Athens.

On 28 July 1983, the Commission complied with the task allotted to it at the Stuttgart Summit Conference by

submitting new proposals for the reform of the agricultural policy and improvements in structural policy. The majority of the proposals for the reform of agricultural policy are concerned with the Commission's thoughts on ways of reducing surplus production which had already been submitted as part of the guidelines for European agriculture of 10 November 1981 in response to the mandate of 30 May 1980.

Past experience and initial reactions to the Commission proposals suggest that progress is being delayed by the inability of the national governments to reach decisions in negotiations within the Council rather than by a lack of proposals for reform. Consequently there are still grounds for doubting whether any clear decisions will be reached before December. It is therefore necessary to reflect on the Community's decision-making process. The fate of the European Act submitted by Mr Genscher and Mr Colombo has demonstrated quite clearly that there is no real political determination to carry out more fundamental institutional changes<sup>17</sup>. However, the following proposal involves only limited changes in the organization of discussions within the Council.

It is worth considering whether a change in the role of the Budget Council in the decision-making procedure would help to rationalize the budget discussions. It is conceivable that the Member States agree to the fixing of appropriations to be allocated to individual sectors of the budget and that each of the Councils of Ministers is compelled to adjust its decisions to the appropriations available.

Unfortunately, past experience has shown that the Ministers often take decisions which do not correspond to the appropriations available. The best example of this is the agricultural policy where, as a result of the decisions taken – or not taken – authorization was given for thousands of millions of ECUs in additional appropriations<sup>18</sup>. The proposed consultation procedure would enable us to conclude the budget discussions for 1984 – despite the fact that we are hovering uncomfortably close to the 1% VAT ceiling – even if it is not possible to reach a final decision on every individual issue connected with the reform of the budget and the CAP and with the system of revenue.

<sup>17</sup> Consequently, the Stuttgart Summit Conference could go no further than the signing of a "solemn declaration on European Union" which falls far short of the original proposals. In particular, very little progress was made on the question of majority voting in the Council.

<sup>18</sup> On p. 12 ff of his working paper "Le processus de décision interne du Parlement Européen en matière budgétaire" which was presented at the Bruges Seminar on 16-18 June 1983, G. I s a a c points out that a majority of the Members of Parliament had voted in favour of imposing controls on agricultural expenditure by means of budgetary policy.

<sup>15</sup> The future financing of the Community (COM (83) 270 final).

<sup>16</sup> See also Article 203 of the EEC Treaty.

the battle for export markets. A far better alternative in this regard is the acceptance of losses in market opportunities and employment as long as no success is achieved in overcoming the recession. However, this requires collective discipline on the part of the trading nations. Once this breaks down, each country has little choice but to join in the game.<sup>4</sup>

A second dimension of the present manifestation of protectionism is resistance to adjustment to changed relative price structures. Producers in industries that come under increased pressure from imports refuse to accept the alternative, which is either to regain competitiveness in the threatened industry or to switch to other, more competitive sectors of production. This is understandable, for the transition is associated with the expectation of considerable sacrifices for those affected. However, from an economic point of view clinging to an outdated industrial structure means opting for the inefficient use of available resources and hence forgoing potential increases in welfare. It would be better to help the producers adjust and to bear the costs incurred in the form of temporary payments for loss of earnings, retraining and relocation. To remove the protectionist motivation in this manner and to smooth the way for the necessary restructuring of production is

central to the "positive adjustment policy" that has been expounded in recent years as an alternative to protectionism.<sup>5</sup>

The fact that the instruments of such a policy have scarcely been used seriously or consistently up to now in the battle for free trade may be due partly to technical, financial and organisational problems of implementation.<sup>6</sup> The continuing sluggishness of economic activity also plays a role by making the transfer of released resources to other expanding industries very uncertain, if not wholly improbable. In spite of all the transitional aid they provide, governments can hardly guarantee redeployment, so that the protectionist motivation continues to apply to producers threatened by imports.

There is another factor, however, that limits the scope for "positive structural adjustment". Increasing imports of finished goods from low-wage countries do more than signal a shift in the balance of comparative advantage. Behind them is a massive increase in the worldwide labour supply for certain areas of production that were previously open only to the relatively scarce labour of high-wage industrialised countries. As a result, high-wage labour (in the North) is replaced by low-wage labour (in the South) without there necessarily being sufficient new job openings for high-wage labour. From the point of view of the affected countries in the Northern hemisphere production "emigrates" to the regions in the South with a labour surplus. The industrial countries or their manufacturers threatened by imports are also striking out against this, albeit not fully consciously, when they impose "artificial" restrictions on imports of finished goods from developing countries.

### Increased Exports without Increased Production

The argument that high-wage jobs in the North will be threatened by low-wage competition even in the long run, i. e. after structural adjustment has been completed, is at variance with the prevailing view.<sup>7</sup> Let us examine this more closely.

<sup>2</sup> Cf. in this regard the literature on protectionist policies, e.g. Kym Anderson, Robert E. Baldwin: *The Political Market for Protection in Industrial Countries: Empirical Evidence*, World Bank (Staff Working Paper 492), Washington 1981; Robert E. Baldwin: *The Political Economy of Postwar U.S. Trade Policy*, Center for the Study of Financial Institutions, Graduate School of Business Administration, New York University (Bulletin 1976-4), New York 1976; Robert E. Baldwin: *The Political Market for Governmental Initiative*, University of Wisconsin (mimeo) 1979; Margaret A. Biggs: *The challenge: adjust or protect?*, North South Institute (Canada and Third World Trade No. 1), Ottawa 1980, Ch. 4; William A. Brock, Stephen P. Magee: *Tariff Setting in a Democracy*, in: John Black, Brian Hindley (eds.): *Current Issues in Commercial Policy and Diplomacy. Papers of the 3rd Annual Conference of the International Economics Study Group*, London 1980; Vincent Cable: *Britain, the New Protectionism and Trade with the Newly Industrializing Countries*, in: *International Affairs* 55, I, 1979; Vincent Cable: *Protectionism and Industrial Decline*, London 1983; James H. Cassing: *Alternatives to Protectionism*, in: Irving Leveson, Jimmy W. Wheeler (eds.): *Western Economies in Transition. Structural Change and Adjustment in Industrial Countries*, Boulder, Colorado 1980; Stephen D. Cohen: *The Making of United States International Economic Policy. Principles, Problems, and Proposals for Reform*, New York 1977; I. M. Destler: *Making Foreign Economic Policy*, Washington 1980; Hans Glismann: *Einige politische Determinanten der Protektion. Eine Fallstudie. Paper for the Annual Conference of the Gesellschaft für Wirtschafts- und Sozialwissenschaft in Nuremberg*, 15-17 Sept. 1980; Hans Glismann, F. Weiss: *On the Political Economy of Protection in Germany*, World Bank (Staff Working Paper 427), Washington 1980; Donald Keesing, Martin Wolf: *Textile Quotas Against Developing Countries*, Trade Policy Research Centre (Thames Essay No. 23), London 1980; Melvyn Krauss: *The New Protectionism. The Welfare State and International Trade*, New York 1978; Heinrich Müller-Godeffroy et al., op. cit., Ch. 6; Wendy Takacs: *Pressure for Protectionism: an Empirical Analysis*, in: *Economic Inquiry* 19, 1981; Eric Verreydt, Jean Waelbroeck: *European Community Protection Against Manufactured Imports from Developing Countries: A Case Study in the Political Economy of Protection*, World Bank (Staff Working Paper 432), Washington 1980.

<sup>3</sup> See for example Robert E. Baldwin, op. cit., pp. 12 and 26, and Heinrich Müller-Godeffroy et al., op. cit., pp. 73 and 79.

<sup>4</sup> In the theory of games this situation is called "the prisoner's dilemma".

<sup>5</sup> With regard to this conception of adjustment policy see James H. Cassing, op. cit. A critique of different conceptions of adjustment policy is to be found in Heinrich Müller-Godeffroy et al., op. cit., pp. 142 ff.

<sup>6</sup> Cf. International Labour Office (ILO): *Report of the Tripartite Symposium on Adjustment Assistance and Employment Restructuring in Industrialized Countries Due to Increased Trade Between Developed and Developing Countries*, Geneva (mimeo) 1978; Heinrich Müller-Godeffroy et al., op. cit., pp. 150 ff., and Organisation for Economic Co-operation and Development (OECD): *Adjustment for Trade*, Paris 1975.