

Stahl, Gerhard

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Gerhard Stahl\*

## Medium-term Financial Planning: An Answer to Community Budget Crises?

*In June 1988 the Council, the European Parliament and the Commission concluded an "Interinstitutional Agreement on Budgetary Discipline and Improvement of the Budgetary Procedure". A key element of the agreement is a commitment to medium-term financial planning for the Community for the period up to 1992. Can this agreement put the Community budgetary procedure on a new footing and ensure that the decisions taken at the Brussels summit on agricultural reform and budgetary discipline can be implemented?*

At the Brussels summit in February 1988 the European Heads of State or Government took a number of long overdue fundamental decisions on agricultural reform and the control of agricultural expenditure, on increasing the resources of the structural funds, budgetary reform and on the new system for financing the Community.<sup>1</sup> Adoption of the "DELORS-package" continued the new course and further development of European policy initiated by the Single European Act adopted in December 1985.<sup>2</sup>

However, it will not be possible to implement the crucial decisions taken by the Summit unless the necessary adjustments are made to the annual budgetary procedure. The Interinstitutional Agreement should ensure that the "DELORS-package" can be implemented in the annual budgetary procedures up to 1992.

In assessing the implications of this agreement it might be useful to discuss past experience of European budgetary policy.

### Budget Consultations in the Past

Discussion of the European Community budget has given rise to numerous conflicts in the past. Disputes have arisen on a regular basis over budgetary policy both between the various Member States and between the European Parliament and the Council of Ministers. The list of conflicts includes: rejection of the 1980 draft

budget by the European Parliament, dispute over the British refund and the Mandate of 30 May 1980,<sup>3</sup> action brought by the Council against the 1982 budget, rejection of the 1985 draft budget by the European Parliament, action brought by the Council against the 1986 budget, action brought by the European Parliament and the Commission against the Council for its inability to submit a draft budget for the 1988 financial year on time.

Community budgetary procedure is moving further and further away from the traditional principles of public sector budgetary policy. In its annual report for 1985, the European Court of Auditors noted serious infringements of the fundamental principles of the Community's Financial Regulation; in particular it criticizes the fact that each year's financing needs are not covered by an equivalent amount of annual revenue, i.e. violation of the principle that the budget should be balanced.<sup>4</sup>

In 1987 the Commission was forced to admit that "the Community has sunk into a morass of budgetary

<sup>1</sup> For an assessment of the Summit decisions, see Dieter Biehl: Ein substantielles, aber begrenztes Reformpaket, in: *Integration*, Vol. 11, 2/88, pp. 164 ff. For details of the new financing system, see Rüdiger Messal: Das neue Finanzierungssystem der Europäischen Gemeinschaft, in: *Wirtschaftsdienst*, Vol. 68, No. 4, pp. 210 ff.

<sup>2</sup> On the Single European Act, see Rudolf Hrbek, Thomas Läufer: Die Einheitliche Europäische Akte, in: *Europa-Archiv*, No. 6/1986, pp. 173 ff.

<sup>3</sup> Cf. on the Mandate of 30 May 1980 Gerhard Stahl: Die Lösung läßt noch auf sich warten, in: *Wirtschaftsdienst*, Vol. 61, No. 7, pp. 326 ff.

<sup>4</sup> 1985 annual report of the Court of Auditors, OJ No. C 321, 15. 12. 1986, p. 13.

\* Secretariat General of the European Parliament, Brussels, Belgium. This article presents the personal opinion of the author.

malpractices";<sup>5</sup> it revealed that ever since 1983 the Community had exceeded its authorized revenue and has built up an increasing financial "burden of the past".

In the annual discharge procedures the European Parliament has complained that substantial financial resources included in the budget were not spent. Table 2 shows, for example, that in the 1987 financial year, despite the shortfall in the budget referred to above, only 94 % of the resources available were used.

This apparent contradiction between financial risks which are not covered and financial resources which are not used can easily be explained. Firstly, financial liabilities which should in fact be charged to the financial

year, for example depreciation in the value of stocks, are not included. Secondly, the amounts entered in certain budget lines are not used up owing to difficulties in implementing the budget or delays in decisions on the necessary legal basis.

### Causes of Deficiencies

The shortcomings of the European budgetary procedure have also been highlighted by experts for some time now.<sup>6</sup> Efforts to reform the budgetary procedure and implementation of the budget have so far been unsuccessful.<sup>7</sup>

The reason for these continuing disputes surrounding the budget was not only the complicated system of power sharing between the Council and the EP but also the conflicting interests defended by the various Member States in the Council and the differences between the Council and Parliament which were difficult to reconcile.

Both the overall volume of the Community budget (dispute between net beneficiaries and net contributors) and the budget priorities (agricultural expenditure versus the funding of structural policy and resources for research and development) have given rise to the same debate every year. The way in which the burden of expenditure is shared among the Member States, typified by such concepts as the British refund or special programmes for Greece and Portugal, has also sparked off regular controversies.

In recent years agricultural expenditure has far exceeded budget forecasts, putting additional strain on the budgetary procedure. For example, while the Federal German Government and the French Government were giving priority to expenditure on agriculture, a majority in the European Parliament was insisting that priority should be given to non-compulsory expenditure, i.e. in sectors other than agriculture.<sup>8</sup>

<sup>5</sup> Commission report on the financing of the Community budget, COM (87) 101 final, 3. 3. 1987, p. 2.

<sup>6</sup> Cf. the various contributions on European budgetary policy in Rudolf Hrbek and others (eds.): *Bilan-Perspectives*, College of Europe, Bruges 1984, pp. 584-836.

<sup>7</sup> The Joint Declaration of the European Parliament, the Council and the Commission on various measures to improve the budgetary procedure signed in July 1982, OJ No. C 194, 28. 7. 1982, provided only a temporary solution to the budgetary conflict.

<sup>8</sup> The attitude of the Federal German Government to budget priorities in recent years was made clear in the cabinet decision of 16 April 1986 on European budgetary policy: "In view of the difficulties facing agriculture and the need to reform Community agricultural policy, the financing of agriculture . . . must be given priority. Consequently there is an urgent need to exercise appropriate restraint in other Community policies during this phase . . ."

**Table 1**  
**Financial Burden of the Past**  
(not included in current financial years)

Year	ECU billions
1983	3.0
1984	6.0
1985	8.6
1986	12.2
1987	17.0

Source: COM(87) 101 Final, P. 4.

**Table 2**  
**Utilization of EC Resources**

Year	Utilization in %
1983	92
1984	96
1985	95
1986	95
1987	94

Sources: Annual report of the Court of Auditors, Report on the implementation of the budget for 1987, COM(88)87.

**Table 3**  
**Trend in Agricultural Expenditure in Recent Years**

Year	Agricultural expenditure (EAGGF Guarantee) payment appropriations in m ECU	Annual rise in %	Total budget expenditure (m ECU)	Annual rise in %
1983	15,785		23,101	
1984	18,328	16.1	26,119	13.1
1985	19,723	7.6	27,136	3.9
1986 <sup>a</sup>	22,115	12.1	33,462	23.3
1987 <sup>b</sup>	27,261	23.3	39,846	19.1

<sup>a</sup> 1986 saw a shift in the structure of the budget following the accession of Spain and Portugal since the latter accounted for a smaller than average share of EAGGF expenditure.

<sup>b</sup> The figures for 1987 have been increased by some 4.3 billion ECU for November and December funded on an interim basis by the national budgets of the Member States.

Sources: Court of Auditors annual report, Report on the implementation of the budget for 1987, COM (88)87, own calculations.

The trend in expenditure in recent years has also proved unsatisfactory in terms of the allocation and distribution of funds. Particularly as a result of payments received under agricultural policy the costs and benefits of European budgetary policy have not been distributed equitably among the Member States.<sup>9</sup>

### Interinstitutional Agreement

In the Interinstitutional Agreement (IA) all the parties to the budgetary procedure formally recognized the political compromise reached at the Brussels summit on the future development of the Community up to 1992 as a framework for the annual budgetary procedure. Agreement was thus reached on common budgetary priorities for the next five years which, if they are adhered to, should result in a less contentious budgetary procedure. It was not, as one might have

expected, pressure from the Council which led to this agreement but pressure from the European Parliament and the Commission.

The continuing resistance on the part of some Council delegations to this Interinstitutional Agreement arose from the fact that they interpreted the results of the Brussels summit somewhat differently. Only the day after the final adoption of the conclusions by the Council on 19 February 1988, their interpretation was already a matter of dispute. More specifically, the figures (see Table 4) imposing ceilings on the development of certain areas of policy up till 1992 were regarded by some Council delegations as illustrations which were in no way binding and thus ceased to have any meaning.

In the ensuing negotiations on the IA all the Member States managed to agree on a common interpretation of the budgetary policy implications of the Brussels summit and to translate it into a medium-term financial plan for the period up to 1992.

The IA translates the various Brussels summit decisions affecting the budget (fixing of own resources, change in the Financial Regulation, rules on agricultural and budgetary discipline, increase in the structural funds, etc.) into budget estimates up to 1992.

<sup>9</sup> On the criteria that should apply to the Community budget, see the report by the group of experts on the role of public financing in European integration (McDougall Report), Brussels, April 1977, Vols. I-II; Report by the EP Committee on Budgets on the Community's own resources (Doc. 1.772/80), adopted in the Plenary on 9 April 1981. A more up to date discussion of European budgetary problems, but less comprehensive than the McDougall Report, is: L. Spaventa, G. Koopmann and others: The future of Community Finance, CEPS papers No. 30, Brussels, September 1986.

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In addition, procedures were agreed which should ensure that these guidelines are adhered to in the annual budgetary procedure and that financial planning is regarded as binding.

### **New IA Budgetary Procedure**

The annual budgetary consultations are to be part of a binding 5-year budget plan setting out figures for actual expenditure up to 1992 for six categories of spending.

The five-year financial perspective is updated annually by the Commission on the basis of trends in GNP and prices, before the beginning of the budgetary procedure.

At the same time as these technical adjustments, the Commission submits to the two arms of the budgetary authority any proposals for adjustments it considers necessary to take account of the conditions for implementation. The Council and the EP are required to take a decision on these proposals before 1 May of the current year.

Apart from the regular technical adjustments and adjustments in line with the conditions for implementation, the financial perspective may be revised by a joint decision of the Council and the EP, acting on a proposal from the Commission. Such adjustments are, however, subject to an overall ceiling. The overall expenditure laid down in the IA for individual years up to 1992 cannot be increased by more than 0.03 % of Community GNP.

If Parliament and the Council cannot agree, the original financial perspective remains valid (except for the technical adjustments which the Commission itself makes). Before the end of 1991 the Commission is to present a report on the application of the Agreement, which initially runs until 1992.

### **Implications**

For the next five years the annual budgetary decisions have been taken in advance as regards overall expenditure in real terms and how it is allocated to the main categories of expenditure. A unanimous decision by the budgetary authority is required to alter the agreed structure and the overall volume expenditure, and then only within the narrow margin of 0.03 % of GNP.

This means that agricultural expenditure cannot exceed the planned budget estimates without Parliament's approval. Thus for the first time in the history of the European budgetary procedure

Parliament is able to block additional expenditure on agriculture. Previously this was not possible – except by outright rejection of the budget – since expenditure on agriculture is classified as compulsory expenditure, for which the final decision is taken by the Council, under the Community financial regulations.

For non-compulsory expenditure, which covers all important areas of policy other than agriculture, the IA means the Council and Parliament have undertaken to ensure that the funds allocated will actually be used. This will entail closer coordination between budgetary and legislative decisions. In future a situation must not be allowed to arise in which appropriations cannot be spent because there is no legal basis on which to do so.

The resulting need for closer coordination of budgetary and legislative procedures will also entail extension of the conciliation procedure between the Council and the EP to avoid delays in legislative decisions.<sup>10</sup>

To sum up, the approach adopted by the Council and the Parliament to the budgetary procedure must change considerably. The fixing of financial ceilings means that the focus will no longer be disagreements on additional resources but on the effective and economic use of funds, the overall amount of which has been agreed in principle.

### **Assessment of the IA**

The planned level of expenditure will substantially improve the structure of the Community budget. Over the five-year period compulsory expenditure can rise only by an annual average of 1.9 % whereas non-compulsory expenditure is to increase by 13.8 %. This will significantly reduce the drain on the Community budget as a result of expenditure on agriculture, which has been widely criticized. The percentage of the budget allocated to the agricultural Guarantee Fund should fall from 60.7 % in 1988 to around 56.1 % in 1992.

The IA also takes account of the call for control of expenditure. At least this is the conclusion if one compares the relatively small increases in expenditure with those recorded in the past. During the period 1983-1987 overall expenditure still rose in real terms by an annual average of more than 7 %. For the period 1988-1992, however, the planned annual increase in real terms is just 4 %.

<sup>10</sup> The Joint Declaration of the European Parliament, the Council and the Commission of 4 March 1975 establish a conciliation procedure for legislative decisions with significant financial implications. See OJ No. C 89/1975, p. 1.

Table 4

**Conclusions of the European Council, Preliminary Budget Estimates for 1988 and 1992 (Commitments)**

(in ECU billion; 1988 prices)

	1988	1992
EAGGF Guarantee (Agricultural Guarantee Fund)	27.5	29.6
Financing of stock disposal	1.2	1.4
Set-aside – aids to income	0	0.6
Structural funds	7.7	12.9
EPIDP (European programme for the industrial development of Portugal) <sup>1</sup>	0.1	0.1
Structural operations as a whole	7.8	13
Policies with multi-annual allocations (research – IMPs)	1.4	2.4
Other policies	1.7	2.8
Repayments and administration	3.5	2
Monetary reserve	1	1
	44.1	52.8

<sup>1</sup> Special budget line for the 1988-1992 budgets.

Source: Bulletin of the Federal German Government, No. 27, 24. 2. 1988, p. 231.

The problem of the “financial burden of the past” will be solved by changes in the Financial Regulation<sup>11</sup> to include resources for depreciation and agricultural stock disposal.

Nevertheless a number of shortcomings must be pointed out:

□ The IA gives no indication of what would happen if the parties involved failed to comply with the provisions of the agreement. Since the IA does not replace Community budgetary regulations, it is impossible to rule out a return to the adversarial type of annual budgetary procedure.

□ The financial perspective is valid only up to 1992. A decision still has to be taken on any further medium-term financial planning.

□ There are also some reservations as to the reliability of the figures produced by the Commission in the financial perspective. A particularly striking example is the estimate given for administrative expenditure. The Commission anticipates that from 1988 to 1992 there will be no increase in real terms in the administrative expenditure for the Community institutions. Given that European officials are bound to receive payraises and that new administrative buildings for the European institutions are already planned this is undoubtedly a rather brave assumption.

Despite these criticisms of specific aspects of the Interinstitutional Agreement, its importance should not be underestimated. If it is applied constructively by the parties involved it will open up a new chapter in Community budgetary policy and will make a considerable contribution to achieving a decision-making procedure which is more efficient and geared to long-term objectives.<sup>12</sup>

<sup>11</sup> The changes in the Financial Regulation would, for example, abolish the automatic carryover to the next financial year of commitment appropriations not actually spent, i.e. commitment appropriations not used up would be cancelled. This means that future budgets would no longer be mortgaged by the relevant amounts.

<sup>12</sup> The President of the European Parliament, Lord Plumb, took a similar line when on 26 July 1988 at the conciliation meeting between the Council and the European Parliament on the 1989 draft budget he called for an end to the “civil war” in the budgetary procedure.

Table 5

**Financial Perspective of the IA**

(Commitment Appropriations; m ECU, 1988 prices)

	1988	1989	1990	1991	1992	1988-92 <sup>b</sup> in %
1. EAGGF guarantee	27500	27700	28400	29000	29600	1.9
2. Structural operations	7790	9200	10600	12000	13450	14.6
3. Policies with multi-annual allocations (IMPs, research)	1210	1650	1900	2150	2400	18.7
4. Other policies	2103	2385	2500	2700	2800	7.4
5. Repayments and administration of which stock disposal	5700	4950	4500	4000	3550	
	1240	1400	1400	1400	1400	
6. Monetary reserve <sup>a</sup>	1000	1000	1000	1000	1000	
Total	45303	46885	48900	50950	52800	3.9
Payment appropriations required	43779	45300	46900	48600	50100	
Payment appropriations as % of GNP	1.12	1.14	1.15	1.16	1.17	
Margin for unforeseen expenditure as % of GNP	0.03	0.03	0.03	0.03	0.03	
Own resources required as % of GNP	1.15	1.17	1.18	1.19	1.20	

<sup>a</sup> At market prices. <sup>b</sup> Annual average increase.

Sources: EP report on ratification of the Interinstitutional Agreement, Doc. A2-116/88; own calculations.