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Intereconomics

*Suggested Citation:* Stahl, Gerhard (1992) : Is the European Community facing a fresh financial crisis?, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 27, Iss. 2, pp. 57-61, <https://doi.org/10.1007/BF02926176>

This Version is available at:

<https://hdl.handle.net/10419/140337>

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Gerhard Stahl\*

# Is the European Community Facing a Fresh Financial Crisis?

*The further development of the European Community that has been decided at the Maastricht summit will be impossible to realize without a significant increase in the EC budget and an adjustment to the financing system. What will be the additional financing requirement? How could the Community's financing system be reformed?*

On 10 December 1991 at Maastricht, the Heads of State and of Government of the EC Member States reached agreement on proposals for economic and monetary union and political union. The results will have to be ratified by the EC Member States as amendments to the EC Treaties. However, the Maastricht summit was only the first step in a round of negotiations about reforming the Community. Without agreement about the consequences of the treaty amendments for the EC's budgetary policy and institutional structure, and about reforming agricultural policy, it will not be possible for the decisions taken at Maastricht to be ratified and implemented. The negotiations about these consequences – known as “the Second Delors Package” – are currently under way.

To enable the package to be assessed, this article contains the following:

- a brief look back at the First Delors Package;
- a review of current challenges which necessitate a reform of EC policy;
- a description of the budgetary effects of the Commission's proposals on the Second Delors Package.

## The First Delors Package

The European Community (EC) overcame the economic and political stagnation which had dogged it during the first half of the 1980s by means of the single market programme for 1992, the Single European Act, the decisions to increase the EC's financial resources, the doubling of the Structural Funds, reform of agricultural policy and the introduction of the rules on budgetary discipline. In taking these decisions on the “Delors Package”,<sup>1</sup> the EC responded to such challenges of the first half of the 1980s as:

- unsatisfactory economic growth, rising unemployment and increasingly strong international competition;
- the rapid growth of agricultural expenditure, production of agricultural surpluses and storage of the surplus produce;
- stagnation of the EC decision-making process due to the unanimity principle, i.e. the rule that any Member State could block the further development of Community policy by exercising its veto;
- the exhaustion of the Community's own resources, in conjunction with a budgetary policy which was transferring a constantly rising “burden of the past” to subsequent financial years.<sup>2</sup>

The First Delors Package was a complete one, combining further opening up of markets with regional compensatory measures and the establishment of an accompanying European social policy, while an increase in the EC's financial resources was accompanied by guidelines for budgetary discipline and reform of the decision-making process. During discussion of the First Delors Package the European Parliament in particular insisted that decisions should be taken on progress not only in the sphere of the internal market but in the other political fields at the same time.<sup>3</sup>

The negotiations on the reform of Community policy continued from 1985 (when the White Paper on the

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<sup>1</sup> Cf. for example the Commission communication: Making a Success of the Single Act, COM (87) 100 final; Gerhard Stahl: Medium-term Financial Planning: An Answer to Community Budget Crises?, in: INTERECONOMICS, Vol. 24 (1989), p. 36 ff.; Dieter Biel: Ein substantielles, aber begrenztes Reformpaket, in: Integration, Bonn 1988, pp. 64-74.

<sup>2</sup> Cf. Commission of the EC: the truth about the EC budget, Brussels 1986.

<sup>3</sup> Cf. Resolution of the EP on the Communication from the Commission entitled “Making a Success of the Single Act – A New Frontier for Europe”, OJ No. C 156 of 15. 6. 87, pp. 52 ff.

Internal Market was presented) to 1988 (when the decision was taken to increase own resources and to introduce five-yearly financial planning). The negotiations which took place during those years may be regarded as a model for the current round of reforms of EC policy, which – with the decisions taken at Maastricht – has reached an important stage.

Experience of the First Delors Package shows that substantial progress can be made within the EC only if agreement is reached on a package which comprises all areas of Community policy and thus renders it possible to counterbalance the various interests. The First Delors Package also showed that amendments to the Treaties need not only be approved by the governments and parliaments of the Member States but also to receive the assent of the European Parliament. In the case of the First Delors Package, this assent was symbolized by the conclusion of an Interinstitutional Agreement on binding five-yearly financial planning, which was signed by the Council, Parliament and Commission in June 1988 and which expires in 1992.<sup>4</sup>

### The Challenges Currently Facing the EC

For various reasons, the EC again needs to come to terms with the necessity of reforming its policies.

There have been internal developments in EC policy which require action, such as:

- ☐ the common agricultural policy: after a limited period of success in achieving stabilization (reduction of warehousing, reduction of agriculture's share in the EC budget from 63.9% in 1988 to 57.7% in 1990), expenditure and surpluses are again rising rapidly (in addition to which concessions need to be made on EC agricultural policy in the interests of the GATT talks);
- ☐ the five-year financial plan expires at the end of 1992; in the Interinstitutional Agreement the Commission was asked to submit a report on experiences under the Interinstitutional Agreement and to make proposals for further medium-term budgetary planning and the development of Community finances;
- ☐ the Commission is likewise required to submit a report on the reformed Structural Funds and to make proposals for their future;<sup>5</sup>
- ☐ progress towards completion of the single market, i.e. economic union, was among the factors which led the Heads of State and of Government at Maastricht to agree a timetable for monetary union;<sup>6</sup>
- ☐ the proposed attainment of monetary union and the corresponding reduction in national power to decide economic and budgetary policy will create a stronger need

for support measures to assist weak regions out of the Community budget.<sup>7</sup>

There are also some extremely urgent external challenges facing the EC:

- ☐ these include the dissolution of the Soviet Union and the dramatic political and economic changes in Eastern Europe and, equally, social and political instability in the Mediterranean region;
- ☐ continuing pressure from international competitors is leading to increasingly insistent calls for a European industrial policy and for an expansion of research policy.

### The Maastricht Summit

At the Maastricht summit, important decisions of principle were taken concerning Economic and Monetary Union and Political Union. (Even so, there are grounds for doubting whether they were sufficiently far-reaching to enable the EC to meet the challenges described above. Further improvements are necessary, especially as regards democratic control.) The decisions about economic and social cohesion paved the way for the forthcoming financial discussions:

- ☐ A cohesion fund is to be set up by 31 December 1993 to facilitate the financing of environmental and infrastructural measures in Member States whose GDP per capita is less than 90% of the Community average.
- ☐ The EC's contribution to the financing of structural fund measures is to be increased in order to reduce the burden on national budgets in the economically weaker Member States.
- ☐ The EC's own resources system is to be adjusted so as to benefit the economically weaker Member States.

It was also agreed that once the financial consultations

<sup>4</sup> Interinstitutional agreement of 29 June 1988 on budgetary discipline and improvement of the budgetary procedure, in: OJ No. L 185 of 15. 7. 88, pp. 33 ff.

<sup>5</sup> Article 19 of the Regulation on the tasks of the Structural Funds and their effectiveness (OJ No. L 185 of 15. 7. 88, pp. 9 ff.) stipulates that the Regulation is to be re-examined five years after its entry into force, i.e. in 1992.

<sup>6</sup> The draft treaty agreed at Maastricht states that the transition to monetary union is to be made on 31 December 1996 or, at the latest, by 1 January 1999. For the text cf.: Agence Europe, *The Treaty on Economic and Monetary Union*, Europe Documents, 20 December 1991, pp. 7 f.

<sup>7</sup> During the Maastricht negotiations – which resulted in agreement on incorporating the objective of cohesion in the Treaty – the demand for regional support was put forward by various delegations, adducing research findings, e.g. those of the report by the group of experts on "The Role of Public Financing in the European Integration" (McDougall Report), Brussels April 1977; L. Spaventa, T. Koopmans et al.: *The Future of Community Finance*, CEPS Paper No. 30, Brussels 1986; and the final report of a study for the EP, "A new strategy for social and economic cohesion after 1992", November 1991.

had been completed in 1992, negotiations on the accession of new members of the EC would commence.<sup>8</sup>

To enable these decisions of principle to be implemented, an agreement needs to be reached with the European Parliament (as part of the budgetary authority) on the implications for budgetary policy. In accordance with the decisions taken at Maastricht, the regulations concerning the Structural Funds and the Cohesion Fund also require the assent of the European Parliament.

### The Second Delors Package

At present, it seems likely that the consultations will take the following course:

- ☐ the Commission presented a general strategy paper on 11 February, outlining the proposals it intends to submit;<sup>9</sup>
- ☐ shortly afterwards, the Commission will submit a second document describing its proposals in detail;
- ☐ following discussion by the Council and the EP of the general strategy paper, and taking into account the results of the consultations, the Commission will cast its proposals in due legal form and submit them for a decision.

The Commission hopes that the negotiations about basic issues can be completed within a few months so that both Parliament and the Heads of Government of the EC Member States can give their assent by the time of the European summit in Lisbon in June 1992.

### Scenarios for Budgetary Measures

The following points, in particular, need to be agreed in the forthcoming financial negotiations:

- ☐ What funds are to be assigned to the Cohesion Fund? The Commission has earmarked ECU 2.5 billion for this for 1997, the final year of the latest financial projection. Both the criteria for allocating this amount to projects in the four recipient Member States – Spain, Portugal, Ireland

<sup>8</sup> Cf. Agence Europe, Treaty on Political Union, Europe Documents, 13 December 1991.

<sup>9</sup> Cf. From the Single Act to Maastricht and beyond, COM (92) 2000 of 11. 2. 1992.

<sup>10</sup> The first objective of the Structural Funds is promoting under-developed regions; cf. Article 1 of the Regulation on the Structural Funds, *ibid.*, p. 11.

<sup>11</sup> By way of an indication of the order of magnitude of the planned aid, a specimen calculation is given below: in order to make an effective contribution to development, financial assistance to the value of 2% of the GDP of the recipient country is required. This corresponds to \$14 billion for Eastern Europe and \$34 billion for the CIS, i.e. a total of \$48 billion per annum in Western aid (or 0.35% of the GDP of the OECD countries). If it is assumed that the EC and its Member States will pay about half of the aid, they will have to find some ECU 20 billion for this. If one assumes that about a quarter of this total would be provided via the EC budget, the annual budget contribution would be ECU 5 billion.

and Greece – and the number of years within which the target figure is to be attained have yet to be decided.

- ☐ How large is the further increase in the Structural Funds to be? The Maastricht Declaration merely refers in general terms to the necessity of expanding structural policy. The Commission is aiming for a political compromise under which grants to the regions in the four "poor" Member States (Spain, Portugal, Greece and Ireland) which meet the criteria for the first objective of the Structural Funds would be doubled.<sup>10</sup> It should be noted that allocations from the Cohesion Fund – which are intended only for projects in these four countries – have been included in calculating this figure.

- ☐ What funds can be made available for Eastern Europe and the former Soviet Union (Commonwealth of Independent States)? This is a key question for the EC's future budgetary policy. The services of the Commission are currently assuming that some ECU 2 billion in budget funds will be available. This figure is based on the assumption that the EC will assume a special commitment towards the East European countries and that aid to the CIS will fall short of more ambitious expectations.<sup>11</sup>

- ☐ What budget funds will be required to finance agricultural expenditure? Trends in agricultural expenditure will depend on decisions which have yet to be taken concerning reform of agricultural policy. The Commission's current proposals on reforming agricultural

Table 1

### EC Financial Perspective (ECU billion 1992)

Commitment appropriations	1987	1992	1997
1. Common agricultural policy	32.7	35.3	39.6
2. Structural operations (including the Cohesion Fund)	9.1	18.6	29.3
3. Internal policies (other than structural operations)	1.9	4	6.9
4. External action	1.4	3.6	6.3
5. Administrative expenditure (and repayments)	5.9	4	4
6. Reserves	0	1	1.4
<b>Total</b>	<b>51</b>	<b>66.5</b>	<b>87.5</b>
Payment appropriations required as % of GNP	49.4 1.05	63.2 1.15	83.2 1.34
Own resources ceiling as % of GNP	(none)	1.20 (except VAT = 1.40%)	1.37
N.B.: Average annual GNP growth			
1997-1992 (actual)	3.1%		
1992-1997 (projected)	2.5%		

Source: From the Single Act to Maastricht and beyond, COM(92) 2000 of 11. 2. 1992, p. 39.

policy will temporarily lead to significantly higher agricultural expenditure and hence to the guidelines for agricultural expenditure being temporarily exceeded (under which the annual increase in agricultural expenditure is not to exceed 74% of the rise in GNP), in order to limit expenditure thereafter. For the purpose of the five-year financial forecast, the Commission assumes that, in spite of a short-term excess in 1995/96, agricultural expenditure will not, on average, rise more rapidly than permitted by the guidelines. A figure of ECU 36.5 billion for the base year 1992 is taken as a starting point for calculations.<sup>12</sup>

□ What expenditure on research is envisaged? It is estimated that expenditure on the Framework Programme for Research will increase by around 10% per annum. A possibility which is currently being discussed is that of altering the Structural Funds in such a way as to allow research also to be promoted more under structural policy.

The above leads to the figures shown in Table 1 for 1997 as the final year in a new five-year financial perspective.

#### Conclusions from the Specimen Calculation

The following conclusions can be drawn from the specimen calculation:

□ The Commission proposes that the EC's own resources be increased to 1.37% of GDP. Bearing in mind that the Commission considered an increase to 1.5% to be necessary at the time of the First Delors Package in December 1987,<sup>13</sup> it is clear that the Commission wishes to propose a "realistic" figure in order to ensure that there is some possibility of agreement being reached before the end of Portugal's tenure of the presidency of the Council. This means that the Council, the European Parliament and the Member States must be prepared to determine their position on the outlines of the Commission's proposals within a few months.

□ In a number of fields, the Commission's proposals fall short of the more far-reaching demands of Member States, the European Parliament and the European Council. For example, the Spanish Government called for a Cohesion

Fund of the order of magnitude of ECU 4-6 billion, and at its meeting in Milan in 1985 the European Council set a target of increasing expenditure on research and technological development to 6% of the Community budget. The European Parliament took up this target and has repeatedly called for its achievement.<sup>14</sup>

□ Without knowing what decisions will be taken concerning agricultural reform it is impossible to say whether the figures for agriculture are realistic and whether there is any guarantee that non-compulsory expenditure will not be supplanted by agricultural guarantee expenditure.

□ An increase in the EC budget represents an additional challenge to national economic and financial policies.

Consolidating budgets and limiting taxation and other levies are important objectives of the economic policies of all the Member States. The provisions agreed at Maastricht for the introduction of a single European currency will further increase the pressure on certain Member States with very high budget deficits to consolidate their budgets. Participation in European Monetary Union is linked to the fulfilment of stability criteria. At Maastricht it was decided that in order for a Member State to participate it would have to comply with the following reference values:

- the budget deficit should not exceed 3% of GDP;
- the national debt should not exceed 60% of GDP.<sup>15</sup>

Only a few countries, such as Luxembourg and France, but not Germany, currently meet these criteria for EMU. As

<sup>12</sup> With reference to the figure of ECU 36.5 billion it is argued that German unification has led to an increase in agricultural expenditure, the basic effect of which should be assumed to be ECU 1.5 billion. On the consequences of German unification for the EC budget see Gerhard Stahl: German Unification and EC Budgetary Policy in: W. Heisenberg (ed.): German Unification in European Perspective, Brussels 1991, pp. 299 ff.

<sup>13</sup> Cf. COM (87) 100 final, pp. 23 ff.

<sup>14</sup> See EP Resolution on Europe's response to the modern technological challenge, OJ No. C 288 of 11. 11. 1985, and Resolution on the framework programme, OJ No. C 15 of 22. 1. 1990.

<sup>15</sup> Cf. Protocol on the Excessive-Deficit Procedure in: Agence Europe, Treaty on Economic and Monetary Union, op. cit., pp. 17 ff.

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the governments of all the Member States agreed to rules for the attainment of European Monetary Union at Maastricht, they must be prepared to pursue economic policies which will enable them to comply with these strict conditions for economic stability within a few years. This may lead to either of two consequences in the forthcoming talks on Community finances:

□ Public opinion and politicians may reject demands for a significant increase in the EC budget on account of the national efforts to stabilize budgets.

□ On the other hand, as the agreed limits on national budgetary policy will render it impossible to continue to finance all expenditure nationally, this implies that the EC will have to finance part of it instead. The reduction agreed at Maastricht in the share of structural expenditure financed from national budgets is based on this very logic.

It seems likely that those countries which would derive particular benefit from the additional EC funding will argue in favour of the latter possibility, while those countries which make a net contribution to the EC budget, such as Germany and the UK, will insist on the more restrictive approach.

#### Fairer Contributions by Member States

In addition to the increase in own resources which has been discussed here, the Commission has also proposed an adjustment to the financing system.<sup>16</sup> (See Table 2.) This change would reduce from 55% to 35% the proportion of own resources financed from VAT revenue. The proportion financed from the fourth resource, which is based on GNP, would increase by a corresponding amount. In consequence the wealthy countries of the Community would contribute more, due to the regressive character of VAT.

Table 3 notably shows that despite their high GNP, Denmark and the Netherlands were net recipients because of the distribution effects of EC agricultural expenditure and that the UK despite its low GNP was a net payer.

A net calculation along these lines may serve to indicate imbalances in the budget, but one should not fall into the error of supposing that it says anything about the costs and

**Table 2**  
**Effects of Changes in the System of**  
**Own Resources**  
(ECU million, 1992)

Member States	VAT 1.4%, 55%	VAT 1%, 50%	Difference
Belgium	2525	2581	56
Denmark	1160	1215	55
France	11975	11823	-152
Germany	17601	17414	-187
Greece	883	852	-31
Ireland	495	480	-15
Italy	9708	10225	517
Luxembourg	116	111	-5
Netherlands	3636	3646	10
Portugal	855	826	-29
Spain	5414	5196	-218
UK	7073	7073	0

Source: EC Commission.

**Table 3**  
**Principal Data on the Budgetary Imbalance in 1990**

	GNP per capita (EC= 100)	Net recipients (ECU per cap.)	Net contributors (ECU per cap.)	Agri-cultural expenditure (ECU per cap.)
Belgium <sup>1</sup>	104.8	-	77.8	85
Denmark	136.2	82.3	-	214
Germany (West)	130.0	-	88.6	62
Greece	37.1	245.9	-	193
Spain	68.0	44	-	52
France	114.0	-	32.1	90
Ireland	64.9	539.7	-	440
Italy	102.8	-	7.2	68
Luxembourg <sup>1</sup>	120.7	-	158.6	14
Netherlands	101.6	24.7	-	177
Portugal	31.1	58.1	-	21
UK	93.3	-	59	31
EC-12	100	-	-	153

<sup>1</sup> If one bears in mind that in 1981-1990 expenditure on administration of the EEC institutions totalled approximately ECU 7 billion in Belgium and ECU 3 billion in Luxembourg, these countries are in fact net recipients.

Sources: EC Commission, own calculations.

benefits of a Member State's membership of the Community. There are methodological problems in allocating revenue and expenditure to Member States appropriately. Moreover, the economic and political advantages of membership should also be taken into account.<sup>17</sup>

To sum up, it is clear that, with the Second Delors Package, the forthcoming negotiations within the EC could be even more difficult than those which led to the treaty amendments already agreed at Maastricht.

<sup>16</sup> Cf. From the Single Act to Maastricht and beyond, op. cit., pp. 33 ff. This adjustment would reduce the ceiling for the VAT base from 55% to 50% of GNP, in addition to which the maximum call-in rate would be reduced from 1.4% to 1%.

<sup>17</sup> For example, for the Federal Republic of Germany exports into EC member states have risen between 1985 and 1990 from ECU 120 billion to ECU 170 billion. German exports into Third countries only increased from ECU 121 billion to ECU 142 billion during the same period.