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# EU Finances in Need of Reform

One of the most important points on the extensive agenda of the European Union is the regulation of financial relationships after 1999. The subject is an explosive one, for it concerns distributional conflicts: conflicts between prosperous and less prosperous member states, conflicts among the net contributors about the appropriate distribution of the burdens, between present (Southern European) and future (Eastern European) recipients of structural funds, between farmers (and their political allies) and all the remaining branches of the economy. The preparations for the new mode of financing therefore cannot begin early enough. Two things should be clear at the outset. Firstly, payments to present member states must be reduced in favour of the acceding Central and Eastern European countries; this requires a radical reconsideration of the tasks and policies of the Community. Secondly, the unequitable development of net contributions to the EU budget, whereby Germany's payments, at an estimated ECU 11.4 bn for 1995, are considerably greater than those of all other net contributors together (ECU 7.7 bn), urgently requires correction.

It is a fact that the high, and growing, financial transfers at a time in which domestic budgetary restraints are continually becoming tighter, are increasingly a cause of annoyance not only in Germany. The financial contributions of the individual member states are determined above all by the size and the rate of growth of the EU budget. In the eight years from 1987 to 1994, the year of the "northward enlargement", the EU budget doubled from ECU 35 bn to ECU 70 bn. This increase "explains" by far the largest part of the increase in Germany's gross contribution in the same period from DM 19.8 bn to DM 41.0 bn. The effects of German reunification and exceptional developments account for DM 4.5 bn. Following enlargement, the EU budget has continued to grow rapidly, reaching ECU 82 bn in 1996. If a brake is to be put on the rate of growth of financial transfers, one must therefore begin with the budget itself. One starting-point could be to freeze the upper limit for revenue and expenditure at its present level of 1.22% of GNP, in other words to suspend the planned expansion to 1.27% by 1999. This would at the same time create a margin for the financing of the acceding countries from Central and Eastern Europe.

There are two large blocks of expenditure which determine the development of the EU budget: the Common Agricultural Policy and the Structural and Cohesion Policy. Expenditures for the Common Agricultural Policy presently make up almost half of the EU budget at about ECU 41 bn. Although their share has shown a tendency to fall since the seventies, in absolute terms expenditures have continually expanded and according to the Medium-Term Financial Perspective they are to increase further in real terms up to 1999. There is no economic justification for this. A second starting-point could therefore be the freezing of agricultural expenditure at the present real level (better still: at the present nominal level) as a first step towards a more fundamental reform based on the principle of subsidiarity. In view of the reorientation of agricultural policy away from price support towards acreage-related income support, this reform should be combined with a reduction in agricultural support from the Community in favour of national measures. Only in this way can a situation be achieved in which the different levels of income in the individual member states are also reflected in differing agricultural incomes.

The Structural and Cohesion Policy presently accounts for 33% of the total budget and this figure is to increase to 35% by 1999. In absolute terms, according to the decision taken at the Edinburgh summit in 1992 structural expenditures are to increase in the period from 1993 to 1999 from an annual ECU 21.3 bn to ECU 30 bn (at constant 1992 prices). This

substantial expansion of funds was the political price which the wealthier "North" had to pay for the agreement of the "Southern states" to the Treaty of Maastricht. It is to be recommended here – thirdly – that funds are concentrated on the regions which are furthest behind in their development and that the participation rates of the Community are reduced from 75% to 50%. This could lead to an increase in the economic efficiency of structural policy and at the same time savings could be achieved. It is a fact that the efficiency of structural policy leaves much to be desired. It must also be clear that there must be no renewed increase in structural funds for the cohesion countries as the price for progress by the core countries towards the monetary union or as the price for the EU's eastward enlargement.

In addition to the volume of the EU budget, the determining factor for the gross contribution of the individual member states is the funding ratio. The EU has four sources of "own" revenue: (1) variable levies on agricultural imports from third countries and levies under the common market organisation for sugar; (2) customs duties on imports of goods from third countries; (3) own value-added tax funds of at present 1.33% of the harmonised assessment base, whereby this base in turn is limited to 55% of GNP; (4) own GNP resources to the tune of 0.33536% of GNP (1995), which serve to cover the remaining funding requirements. Value-added tax and own GNP resources do not place a direct burden on the taxpayer but are financed from the national budgets. With a share of 28.1% of the EU's GNP in 1995, Germany contributed 29.3% of the Community's own resources. Measured only against value-added tax and own GNP resources, to which the national contributions can most easily be ascribed, Germany's share even reached 30.1%. According to the first yardstick Germany paid about ECU 840 million "too much" in taxes and duties to the EU, and according to the second yardstick the figure was ECU 1.1 bn. Of course, the same is true for other countries as well and is due not least to the reduction granted to the United Kingdom of a total of ECU 1.5 bn (of which ECU 333 million are at the cost of Germany). A fourth starting-point would therefore be an improvement in the revenue key: by setting a uniform upper limit for the total amount of value-added tax and own GNP resources to be paid by each member state, measured as a percentage of the member state's GNP, and by opening up the corrective mechanism, which is presently limited to the UK only, to all countries which qualify for it. In addition to this, it should be considered collecting the Community's value-added tax in the form of a surcharge to the (correspondingly reduced) national tax directly and openly from the consumers and to collect own GNP resources in future only at the level necessary to balance out peak requirements.

The gross contributions to the EU are only a part of the problem, however. More important is the level and the trend of net contributions after the payments from the EU budget to the member states have been deducted. One thing must be clear in this context: in an EU based on the principle of solidarity the Federal Republic of Germany, with its high income, will continue to be the largest net contributor in absolute terms. Exception must be taken, however, to the strongly distorted distribution of the burden: according to the figures named in the public discussion, in 1995 Germany alone was responsible for 60% of all net contributions, at ECU 11.4 bn, followed at a great distance by the United Kingdom with ECU 2.2 bn; but even Italy, with its much lower income, belonged to the net contributors with ECU 1.3 bn. Per capita Germany contributed ECU 141, Sweden ECU 101 and the Netherlands ECU 93, while only ECU 24 fell to France, for example. These differences cannot be justified by differences in income. Such rich countries as Denmark and – as the seats of the EU authorities – Luxemburg and Belgium, even belonged to the net recipients. This distorted distribution is a result of the pattern of EU expenditure with its concentration on agricultural and structural expenditure, which was already pointed out above. The medium-term solution therefore lies in a reform of these policies in the direction indicated, but in the interim in a revised financial corrective mechanism which ensures an appropriate per capita distribution of the burdens among the countries with higher incomes. This condition must be met after 1999 if the EU is to continue to find the necessary broad acceptance in the future.

*Hans-Eckart Scharrer*