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**Research Report**

## An early start for EU reform: Germany's options for the 2008/09 revision of the European financial constitution

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# SWP Research Paper

Stiftung Wissenschaft und Politik  
German Institute for International  
and Security Affairs

*Peter Becker*

## An Early Start for EU Reform

Germany's Options for the 2008/09 Revision of  
the European Financial Constitution

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**An Early Start for EU Reform.  
Germany's Options for the 2008/09 Revision of the  
European Financial Constitution**

Surprising the doomsayers, the European Union has proved its ability to act decisively, and adopted a Financial Framework for the next seven years. The representatives of the European Parliament, the Council, and the European Commission agreed on April 4, 2006, on a new Interinstitutional Agreement, whose central component is the "Financial Perspective." This supplies the framework into which the annual budgets for 2007 through 2013 must fit.

At first glance the EU's financial and budget system has demonstrated its functioning capacity. But closer examination shows, however, that there are good reasons to doubt whether this system will be able to guarantee the Union's capacity to act in future and whether the present structure of the EU budget can still cope with the current challenges facing the Union. The conflicts that broke out between the member states and the harshness with which the negotiations were conducted—especially in the final phase—stand in no relation to the actually rather small sums involved. The European Union's financial and budget system is threatening to erode away. These worries are not restricted to external observers—as demonstrated not only by the critical voices from the European Parliament, but also by the European Council's December 2005 compromise itself, where a special revision or "rendez-vous" clause was inserted to satisfy demands for fundamental reform of the EU funding system.

The aim and purpose of the revision debate scheduled for 2008/09 must be a comprehensive and far-reaching reform of the EU's financial constitution that examines both the spending and revenue sides. For that reason it is important that the European Council's conclusions explicitly link the Common Agricultural Policy with the British budget rebate and thus name the decisive factors for the current policies of defense of national privileges and for the resulting reform logjams. Connecting these two main thrusts of reform—on the revenue and spending sides—could lead to a comprehensive and lasting reform of the structures of the EU funding system. By virtue of its financial volume and the difficulty in defending the privileges involved, the British rebate could prove to be the only effective lever for breaking open the cur-

rently ossified status quo on the spending side. The outcome of the comprehensive overhaul of the EU's financial and budget system could without a doubt exert a significant influence on the further development of the European Union and the continuation of the European integration process.

If the debate over restructuring the financial constitution is to lead to success for the European integration process, the time before the start of the actual revision phase itself, 2008/09, must be used to agree on concrete goals for reform without getting lost in the no-man's-land of net balance. For there is certainly a danger that the beneficiaries of the status quo regard the revision as a non-binding preliminary to the real budget negotiations beginning in 2011 for the 2014–2020 Financial Framework. Unless they are placed under material and time pressure to agree these member states could be tempted to water down over-ambitious reform proposals or even concrete decisions of the European Council in meaningless discussions of principle. But the Union has to find answers to a multitude of questions: What does the EU spend its money on and according to which criteria are the spending priorities defined? What role do the premises of European added value and efficiency play here? What degree of financial autonomy should the European Union be granted by its member states? How can the EU funding system be made more transparent and how can its democratic legitimacy be enhanced by improved parliamentary participation?

One conspicuous factor is the foreseeable coincidence of the revision debate in 2008/09 with the unpostponable negotiations over reducing the size of the European Commission and the discussions about the most important European appointment, namely of the new (or old) Commission President, which will probably be beginning then. Furthermore, certain actors have already begun defining their positions on a revision of the European financing system. The European Parliament proposed in its resolution of March 29, 2007, a two-stage plan for reforming the EU own resources system as well as further meetings between the European Parliament's budget experts and those of the national parliaments. The European Commission published its fourth cohesion report on May 30, 2007, providing a detailed analysis of and a comprehensive data set on the economic and social situation of the enlarged Union, indicating the main challenges the cohesion policy may be confronted with in the coming years and outlining an initial set

of questions to kick off the debate on the future of the European Structural Policy.

The formulation of the *rendez-vous* clause is sufficiently vague to allow scope for various interpretations. It thus offers the opportunity to prestructure the revision debate at an early stage, to control the timetable of the debate, and to influence the formulation of the negotiating priorities. What is required is first an agreement within the European Union on the result to which the revision process should lead, how the European Parliament can be involved more actively in the debate, and which concrete reform goals should be placed at the center of the debate.

The EU partners should agree that the goal of reform must be to bring about a clear shift in the priorities of EU spending policy to allocative policies and on the revenue side to give the EU greater autonomy. In the medium term the multi-year Financial Perspective could then be developed into an integration policy planning instrument where political priorities are given concrete financial backing. This ambitious reform project can only become reality if all member states are willing to undertake a real change in the status quo, and to adapt the EU's financial constitution and the Union as a whole to the new conditions and challenges of the globalized world. A consciously conducted revision debate orientated on this goal offers a framework to discuss the tasks of the EU budget away from the limelight of media attention and the focus on national net balances. Therefore the upcoming decision on whether to use the revision clause actively or to delay taking a stance for as long as possible is also at its heart a fundamental choice of integration course, and more than a purely budgetary or procedural question.

## The Starting Point: The Outcome of Negotiations on the New Agenda 2007

After the European heads of state and government finally reached a political understanding on a new Financial Perspective for 2007 to 2013 in the small hours of December 17, 2005, their first reactions clearly revealed how shocked they were and how immensely difficult the negotiations had been.<sup>1</sup> Austrian Chancellor Wolfgang Schüssel said: “The funding system is on its last legs. We can’t go on like this. Next time we’ll be going for each other’s throats.”<sup>2</sup> It was no coincidence that the first public statements by the heads of state and government exhibited deep-seated mutual mistrust, and enormous skepticism about the whole future of this system and the prospects of ever reaching such a consensus again. And it was no coincidence that agreement about the Financial Perspective was only possible because at the same time a thorough overhaul of the system had been agreed. A “rendez-vous clause” in the European Council conclusions provides for a “comprehensive reassessment of the financial framework,” including both revenue and expenditure. The European Commission is called on “to undertake a full wide-ranging review” and to present a report in 2008/09, on the basis of which the European Council will then “take decisions on all the subjects covered by the review,” which are to be taken into account in the negotiations on the next Financial Perspective.

In the meantime, however, the impetus for reform seems to be ebbing away again. Increasingly we hear statements to the effect that the timely conclusion of this negotiating process under the most difficult of conditions actually showed that the EU funding system as a whole still works and can ensure the EU’s ability to act. According to this line of thought, the Union will continue to have at its disposal a plannable

and predictable Financial Framework providing sufficient funds, at least for the most important tasks.

But although this compromise was achieved under extremely difficult political and economic conditions, it is more than doubtful whether the existing funding system will be able to guarantee the Union’s future ability to act and whether the current structure of the EU budget will be up to the Community’s future challenges.<sup>3</sup> The critics always point to structural deficits that cannot be addressed through piecemeal adjustments. Among other things, they call for a fundamental and comprehensive rethinking of spending priorities and a fairer, more transparent funding system. To make matters worse, the EU—which already has twenty-seven members and will soon have more—is already characterized by extreme economic and social disparities between its member states. This means that the expectations and demands placed on the Union are likely to grow still further, the redistribution volume will continue to grow, and new compensation mechanisms will be developed. At the same time the EU increasingly finds itself called on to fulfil an international political role, leading to a growing demand for funding for its civilian foreign policy instruments. So the EU is confronted with great internal tensions and external expectations, which will require appropriate level of funding if they are to be dealt with. At the same time—as the tough negotiations over the Agenda 2007 have just shown—the member states’ willingness to provide the EU with additional financial resources is limited. The only option in this situation is first to redefine the European Union’s political priorities for the use of its restricted means and then also to apply them more efficiently.

The new Interinstitutional Agreement on Budgetary Discipline and Sound Financial Management concluded on April 4, 2006, largely corresponds to the agreement

<sup>1</sup> After more than two years the negotiating process for the Financial Framework for 2007–2013 was provisionally concluded on April 4, 2006, with an Inter-institutional Agreement between the Council of Ministers, the European Parliament, and the European Commission. However the process of ratifying the new EU own resources decision in the national parliaments only began in 2007.

<sup>2</sup> Quote translated from *Süddeutsche Zeitung*, December 31, 2005; also “Barroso fordert nach Streit um EU-Haushalt ‘völlig neues Verfahren,’” *Handelsblatt*, December 20, 2005.

<sup>3</sup> For example, Iain Begg and Friedrich Heinemann, *New Budget, Old Dilemmas* (London: Centre for European Reform, February 2006); Maxime Lefebvre, “Le budget Européen 2007–2013: Une négociation d’étape,” *Revue du marché commun et de l’Union européenne* 500 (July/August 2006): 445–51; Peter Becker, “Fortschreibung des Status quo – Die EU und ihr neuer Financial Framework Agenda 2007,” *Integration* 29, no. 2 (April 2006): 106–21.



## Overview 1

### Additions to the EU Budget for 2007–2013 in the Interinstitutional Agreement of April 4, 2006 (by heading)

Heading	million €
1a Competitiveness for growth and employment	2,100
<i>Trans-European Networks</i>	500
<i>Life-long Learning, Erasmus, Leonardo</i>	800
<i>7th Research Framework Program</i>	300
<i>Competitiveness and Innovation</i>	400
<i>Social affairs (Progress)</i>	100
1b Cohesion for growth and employment	300
<i>Promotion of territorial cooperation</i>	300
2 Preservation and management of natural resources	100
<i>Life+ and Natura 2000</i>	100
3 Citizenship, freedom, security and justice	500
<i>Health and consumer protection</i>	200
<i>Cultural programs such as Youth for Europe, Culture for Europe, Citizens for Europe</i>	300
4 The EU as a global player	1,000
<i>European Neighbourhood Policy</i>	200
<i>Common Foreign and Security Policy</i>	800
<b>Total</b>	<b>4,000</b>

reached by the twenty-five heads of state and government. However, the European Parliament succeeded in making a number of quantitative and qualitative changes to the original political understanding reached by the European Council.<sup>4</sup>

These amendments increased the volume of the EU Financial Framework for 2007–2013 by €2,000 million, bringing total spending to 1.045 percent of the GNI of the EU25 (in commitment appropriations). The originally planned spending was also reduced by €2,000 million through savings in administrative expenditure and excluding the Emergency Aid reserve from the budget, so in fact an additional €4,000 million is now available for the EU's programs (see Overview 1). This agreement became possible after the European Parliament withdrew its original demand for the Financial Framework to be increased by €12,000 million over and above the compromise of December 2005, and the governments of the EU

member states were willing to shift somewhat from their original compromise.<sup>5</sup>

With a total volume of €864,300 million, the new Financial Perspective seems at first glance much closer to the demands of the six net contributors—whose letter of December 15, 2003, called for the Financial Framework to be limited to 1 percent of the EU's GNI or approximately €815,000 million—than to the wishes of the Commission, which on February 10, 2004, had proposed a total budget volume of €1025,026 million in commitment appropriations (on average 1.26 percent of the EU's GNI) for the next Financial Framework (see Overview 2).

Closer examination, however, shows that the funding compromise is characterized by the creation of new flexibility reserves outside the budget framework.

<sup>4</sup> European Parliament, *Report on the Interinstitutional Agreement on Budgetary Discipline and Sound Financial Management*, rapporteur Reimer Böge, A6-0150/2006, April 27, 2006.

<sup>5</sup> This agreement was negotiated in four triologue meetings in early 2006 (January 23, February 21, March 21, and April 4) by representatives of the European Parliament, the European Commission, and the Council Presidency. After the Council of Ministers adopted the compromise of 4 April by written procedure the plenary of the European Parliament also gave the new Interinstitutional Agreement on Budgetary Discipline and Sound Financial Management a clear majority on May 16, 2006 (440 in favor, 190 against, 15 abstentions).

## Overview 2

## Proposals for the EU Budget 2007–2013 (by heading, million €)

Heading	EU Commission (Feb. 10, 2004)*	European Parliament (June 8, 2005)	Luxembourg proposal (June 17, 2005)	British proposal (Dec. 14, 2005)	European Council agreement (Dec. 17, 2005)	Interinstitu- tional Agree- ment with the European Parliament (April 4, 2006)
1a Competitiveness (Lisbon Strategy)	121,685	110,600	72,010	72,010	72,120	74,098
1b Cohesion (Structural Funds)	338,710	336,330	309,594	298,989	307,619	308,041
2 Preservation and manage- ment of natural resources	400,275	396,306	377,800	367,294	371,245	371,344
<i>of which: agricultural market expenditure and direct pay- ments</i>	301,074	293,105	295,105	293,105	293,105	293,105
3 Citizenship, freedom, security and justice	20,945	16,054	11,000	10,270	10,270	10,770
4 The European Union as a global player**	84,650	63,985	50,010	50,010	50,010	49,463
5 Administration	57,670	54,765	50,300	49,300	50,300	49,800
6 Compensations (Bulgaria, Romania)	0,8	0,8	0,8	0,8	0,8	0,8
Commitment appropriations	1025,355	974,840	871,514	809,319	862,364	864,316
<i>in % of GNI</i>	1.240	1.182	1.057	1.03	1.046	1.048

\* In the Commission's proposal the administrative costs were shared out among the different headings. In order to maintain comparability with the European Council's table the administrative costs are combined here according to heading 5, administration, in the Commission's list in Fiche No. 17 "Indicative estimates of administrative expenditure" of May 12, 2004.

\*\* In this row, note that in the Council's negotiations funding for cooperation with the ACP states through the European Development Fund totaling €22,700 million was excluded.

If we add up these special funds we find an additional volume of about €36,000 million (see Overview 3). Thus the actual available funding volume of about €900,000 million is considerably higher than the €864,300 officially stated in the Interinstitutional Agreement. This method of excluding special funds from the scope of the Financial Perspective 2007–2013 corresponds to the familiar practice of earlier budget negotiations. It makes it easier for the two EU organs—Council and Parliament—to find on a compromise that allows both sides to save face.<sup>6</sup>

<sup>6</sup> In the negotiations the Council focuses primarily on observance of budget discipline and restricting the volume of the budget. In its negotiations with the European Parliament, the European Council's compromise was to remain largely untouched in all other respects. The European Parliament, on the other hand, attempts to increase the overall volume of

## Overview 3

## Flexibility Reserves Outside the Official EU Budget 2007–2013 (million €)

European Development Fund	22,700
Solidarity Fund for disaster relief in the EU	7,000
Reserve for emergency aid to third countries	1,400
Globalization Fund for aid to globalization losers in the EU	3,500
Flexibility reserve	1,400
Special funds total	36,000

the Financial Framework in order to allow it to pursue its institutional interests in the individual policy fields. The intransparency of the special funds allows the Council to claim to have restricted the overall volume of the EU budget while conversely the European Parliament can also resort to the special funds to boost spending.

## The Defining Lines of Conflict in EU Funding Negotiations

In the latest battle over the financial perspective net contributors and net beneficiaries faced off again. On one side those member states that are most interested in a binding commitment to budgetary discipline and burden sharing, on the other the countries that expect from the EU financial solidarity and active efforts to promote economic and social cohesion. One special feature of the Agenda 2007 negotiations was that the domestic financial difficulties of the EU's biggest contributors, caused by a long period of weak growth, came to the fore very clearly for the first time, and their financial flexibility was also so clearly restricted by the strict debt criteria of the European Stability and Growth Pact that a generous expansion of the EU budget was excluded from the very outset.<sup>7</sup> On the other hand, in view of the glaring disparities in prosperity between the old and new member states in the expanded EU, the need for funds had plainly grown, which is why calls to increase the budget were particularly strong.

This conflict of interests flared up in the latest round of negotiations to exacerbate the two almost classic fundamental conflicts that had dogged all previous funding negotiations:

1. Friction between the "net payers" and "net recipients," in other words between those member states that pay more into the EU budget than they receive from it and those where the balance is positive.
2. The running quarrel between the United Kingdom and all the other member states over the existence and level of the British rebate. The United Kingdom is the only member state to enjoy the right to an automatically increasing budget rebate, which the other member states have to fund by way of higher contributions.<sup>8</sup>

<sup>7</sup> The German government in particular always argued that it was neither acceptable nor comprehensible for the EU to demand national budget discipline and observance of the strict criteria of the European Stability and Growth Pact while at the same time urging net contributors to increase their contributions to the EU budget.

<sup>8</sup> This exception was introduced in 1984 to redress the structural imbalance between the United Kingdom's contributions to the EU budget as a relatively wealthy country and its low level of receipts from Brussels. Thus this conflict too is part of the "juste retour" way of thinking, in other words the logic of the net balance. Britain responds to criticism of its special role and the budget rebate by attempting to push through greater cuts in the EU's agriculture budget, which London calls the "French check."

The net payer logic dominates over all other considerations and shows in particular that it is still the EU's member states that shape the funding negotiations. For them the development of their own net balance is the decisive criterion for assessing any potential outcome of negotiations. Any change in EU revenues or expenditure is assessed in terms of its effect on the country's own balance of payments into and out of the EU budget, and thus placed in a national cost/benefit context dominated by fiscal considerations. Under this logic each member state works to increase spending in those policy fields where it can count on a high inflow of funds; wherever its own returns would be expected to be less than average it calls for cuts.

Analyzing the weakpoints and the experience of previous funding negotiations allows us to propose the thesis that when all the member states conduct their negotiations strictly according to the outcome for their national net balance there are a number of negative consequences. Firstly, the negotiations regularly enter situations of deadlock with aspects of crisis. It requires long and difficult talks in the final phase of negotiations to find a compromise involving a large number of quid-pro-quo deals. But because these are always preceded by harsh disagreements the agreement is generally perceived, at least publicly, as the lowest common denominator and (even if this is certainly not actually the case with respect to every question of detail) seen not as a forward-looking understanding but at best as a deal thrashed out to avert greater harm. This perception confirms and intensifies the already negative public image of the Union and its organs. Thus the public conduct of the conflicts and the negative connotations of the compromise cause the Europeans' approval of the EU to fall still further.

But this indirect effect of the negotiations is not the only negative influence on the European integration process. The net payer logic and assessments dominated by national fiscal interests also prevent solutions orientated on a joint European interest. Once compromises have been reached and exceptions agreed (and concessions made too), these tend to become entrenched. Because such compromises can subsequently only be altered by consensus they thus attain a binding status that is equivalent to European treaty law. Additionally, the participants show little inclination to venture away from well-trodden negotiating paths. Any fundamental change to the negotiating framework at first brings only increased

insecurity and reduced predictability, especially where the development of the national net balance is concerned. So as a rule the member states stick by existing agreements and merely attempt to influence the outcome of the negotiations by twiddling with existing controls. This result of this kind of behavior is that necessary modifications are delayed and the results are often inadequate or come too late.

## The Key Points of the Revision Process

In the rendez-vous clause of December 19, 2005, the Council of the European Union called on the European Commission “to undertake a full, wide ranging review,” of how the EU funding system can be reformed and to present a report on this in 2008/09. On the basis of this report the Council will then “take decisions on all the subjects covered by the review,” which are to be taken into account in the negotiations for the next Financial Perspective.<sup>9</sup>

It is already clear today that the revision debate will touch on all dimensions and aspects of the EU funding system: revenues, spending, and institutional and procedural questions. Two areas of reform are explicitly named and linked to one another in the European Council’s conclusions:

1. The Common Agricultural Policy, whose financial restructuring basically amounts to the same as reassessing the current priorities in EU spending policy.
2. The UK budget rebate and the associated search for possible adaptations on the revenue side of the EU’s financial constitution.

There is also a third major element in the reform discussion, because the European Commission has already announced that it will again be proposing the introduction of an autonomous source of revenue.<sup>10</sup>

The naming of the Franco-British antithesis in the rendez-vous clause defines the trajectory of the revision debate. It is hoped that this linkage of change on the revenue and expenditure sides will be the decisive lever for cracking the Franco-British impasse.

The timetable for the revision process is largely set by the following considerations:

- a) The current Financial Framework runs until the end of 2013, giving the EU a secure legal and financial basis for the years 2007 to 2013. Negotiations on a new

Financial Perspective will begin as usual with the publication of a communication by the Commission. In the new Interinstitutional Agreement the Commission agrees to publish this communication no later than July 1, 2011.

- b) In its compromise of December 17, 2005, on the Financial Perspective, the European Council requests the Commission to present a report in 2008/09. This report will be published by the end of 2009 at the latest, together with the intermediate evaluation of the implementation of the Interinstitutional Agreement.<sup>11</sup>

So the timetable for a thorough reform debate among the member states is limited to no more than two years—from the presentation of the report on implementation of the Interinstitutional Agreement (probably in mid-2009) to the publication of the communication for a new Financial Framework (no later than July 1, 2011).

However, it is already becoming apparent that discussion of reform of the Financial Framework will begin very much earlier. The Commission has already given the first indications of how it envisages the next preparatory steps for the reform process. It will publish (probably by mid-2007) a green paper in the form of a set of questions and comments intended to launch a structured public debate on the options for reform. This public consultation process will be followed in 2008 by an “analysis of the status quo” in the form of a “White Paper covering all aspects of the financial framework, revenues and expenditure,” which would potentially serve as the basis for structuring the subsequent revision process.<sup>12</sup> Drafting of the Commission’s white paper will in turn be preceded by hearings and conferences, and will also give room to the positions of member states, regions, and interest

<sup>9</sup> Council of the European Union, *Note from Presidency to European Council, Subject: Financial Perspective 2007–2013*, doc. 15915/05, December 19, 2005, items 79 and 80.

<sup>10</sup> Alongside the issues already mentioned, there are other items on the revision agenda too, including synchronizing the terms of office of the European Parliament and Commission with the cycle of the Financial Perspective and the fundamental question of strengthening parliament’s influence in drafting the EU Financial Framework.

<sup>11</sup> *Declaration of the Commission on the Assessment of the Functioning of the Interinstitutional Agreement and Declaration on the Review of the Financial Framework*, annexed to the Interinstitutional Agreement.

<sup>12</sup> European Commission, *Contribution to the Interinstitutional Negotiations on the Proposal for Renewal of the Interinstitutional Agreement on Budgetary Discipline and Improvement of the Budgetary Procedure*, (working document) COM (2006) 75 final, February 15, 2006, 2.

groups.<sup>13</sup> In addition, the presentation of the Commission's Fourth Cohesion Report on May 30, 2007, was important, because this document outlines the necessities and options for reform in an important field of policy, namely, European structural and cohesion policy. So already this year the Commission's communications will be initiating and outlining the revision debate.<sup>14</sup>

The European Parliament has also raised its voice at an early stage in this debate. On March 13, 2007, its rapporteur, Alain Lamassoure, presented a report on the future of the European Union's own resources, which was adopted on March 29, 2007, by a large majority.<sup>15</sup> It proposes a two-stage reform, with the first step being to abolish all exceptions and rebates by 2013 and to fund the EU budget through a uniform percentage of the gross national income of each member state. The second stage, starting in 2014, would introduce a system of genuine "own resources" for which the European parliamentarians propose the payment of a limited and clearly identifiable proportion of an existing national tax.<sup>16</sup>

In the negotiations over the new Interinstitutional Agreement the European Parliament ensured that in the phase after publication of the Commission's white paper it will be appropriately included in the scope of "on the basis of the normal political dialogue between the institutions" and that the European Parliament's positions will be "duly taken into account."<sup>17</sup> If the European Council reaches concrete decisions in the further course of the revision process it must involve

**13** It would also be conceivable to appoint an external advisory group ("group of wise men and women"), which the Commission could call on to prepare the revision negotiations and assess the different national positions before the actual negotiations start.

**14** Under the Commission's plans the second major field of EU spending—the Common Agricultural Policy—should also be subjected to comprehensive overhaul in 2008. The debate over reform options in this field of policy has already begun.

**15** European Parliament resolution of 29 March 2007 on the future of the European Union's own resources, P6\_TA-Prov(2007)0098. Lamassoure sought direct contact with the national parliaments at an early stage of the preparations for his report, in the form of a questionnaire and through discussions with the national parliamentarians.

**16** In its resolution the European Parliament speaks of "the complete failure of the current system," which is "unfair" and "anti-democratic."

**17** In the negotiations over the Interinstitutional Agreement the Council initially attempted to prevent MEPs being formally integrated in the process.

the parliament "in accordance with the relevant procedures and in full respect of its established rights."

So in the first phase of the revision process, up to publication of the Commission's white paper, the institutions of the Union—Commission and parliament—will dominate the debate. They will attempt to focus the discussion on their goals, their political priorities, and their preferred reform options. For the member states, however, this division of roles in no way means that they can afford to be inactive. Rather, it would be expected that especially those parties whose interests are directly affected by the revision process will work to influence the Commission's initiating statement. Just as the European Parliament has done through the Lamassoure report, the Commission and interested member states will also attempt to put their ideas and positions onto the reform agenda at an early stage. That means that in the coming months the battle lines for the subsequent debate will already be getting drawn up and that the reform process is already getting under way during the German Presidency.

Those actors (institutions and member states) who are interested in reform should therefore quickly decide on the political goal of the revision clause and initiate the first steps toward structuring the discussion process. Here the material range of the negotiating topics will be determined by two main factors:

1. The revision process will certainly not anticipate the negotiations on the future Financial Framework beginning 2014. So neither the volume of the budget nor the specific distribution of funds to the various budget headings and policy fields will be discussed. Those negotiations will not begin until 2011/12.
2. The participants in the reform debate are not in a position to attempt to modify the underlying treaties. Any proposal that would require amending European primary law (for example changing voting arrangements) must be unrealistic as long as it remains unclear how the EU intends to proceed with the Treaty establishing a Constitution for Europe.<sup>18</sup>

The starting position at the beginning of the reform debate is by no means unchallengeably defined; instead there are various plausible perspectives on what

**18** At best the revision process can be based on the status quo of the Treaty establishing a Constitution for Europe as a de facto political consensus—but not de jure until conclusion of the ratification process.

should actually be reformed. The first obvious basis for the Commission's "analysis of the status quo" is the existing legal framework, the Financial Framework 2007–13. An alternative starting point, however, would also be the legal framework as reformed by the Treaty establishing a Constitution for Europe. The constitutional treaty proposes including the Financial Perspective in European primary law and altering the procedure for adopting the annual budgets. However, it is significant that in the European Convention and the Intergovernmental Conference on the constitutional treaty there was already heated discussion of the options for reforming the European budgetary and financial constitution, which could also be crucial for the 2009 revision process. In that sense the constitutional treaty represents the legal expression of the politically feasible, the best possible compromise.

Depending on which basis the Commission draws on for its analysis of the status quo, additional or at least modified questions may arise. For example, falling back on the European constitutional treaty might mean that discussions that have already been conducted in the Convention and the subsequent Intergovernmental Conference would not have to be repeated. This would mean that questions such as the introduction of an EU tax, qualified majority voting on the multi-annual Financial Framework and further strengthening the European Parliament at the expense of the Council in the adoption of the EU's annual budgets would not have to be discussed yet again. Consequently, basing the discussion on the European constitutional treaty would lead to a narrowing of the reform agenda. On the other hand, choosing the constitutional treaty as the basis for negotiations would increase the likelihood that the revision process would concentrate on pragmatic topics and proposals that enjoy realistic prospects of implementation.

Although the revision clause was fleshed out in the Interinstitutional Agreement and the emerging time-frame is relatively firm, the rest of the process remains unclear. A format for the negotiating process has not been specified, and no additional material key points—still less concrete targets for the planned comprehensive reform of the EU Financial Framework—have so far been stated. This very lack of definition opens up both opportunities and risks, because every influence exerted on the structure and course of the process can either introduce additional topics and set new accents—or, conversely, prematurely scupper efforts to concentrate on a realistic reform agenda. Depending

on whether other EU institutions and civil society interest groups are involved or heard (and which) for example new scenarios can be brought to bear against the Common Agricultural Policy or old ones torn down.

For the concrete shape of the revision process this means that three questions have to be decided first:

1. On what basis should reform of the EU funding system be initiated? Should the European constitutional treaty and the consensus it represents be the point of reference, or instead existing primary law and the Agenda 2007?
2. What structure should the revision process have? How should the European Parliament—which was the first organ to open the process with the Lamasoure report—be included in the debate? Should civil society groups be integrated in the process too or should for example a consultative or expert body be asked to formulate and calculate reform options and scenarios before the actual negotiations proper?
3. How could material reform steps, beyond the formulation of a decision of the European Council, be further concretized?

It is these the process-structuring questions that most need answering. The form, the timing, and of course the content of the answers will predetermine the outcome of the reform process in 2009.

## Potential New Influences

Alongside these crucial decisions that the EU member states should make before the revision process starts, the European political environment will be decisive for the debate's structure and its prospects of success. An altered international situation, domestic upheavals in important member states, or also the possibility (or need) to conduct and conclude negotiations on other topics at the same time as the revision talks on the future European Financial constitution could cause the positions of important negotiating parties to shift or also introduce new, previously immaterial aspects into the negotiating process. As well as important domestic political events in particular member states, such as the French presidential and parliamentary elections, the upcoming decisions at the European level should not be forgotten. Negotiations on the future of the Treaty establishing a Constitution for Europe and/or how to continue the ratification process could certainly impact on the debate over reform of the funding system. And the necessity, as laid down by treaty, to reach a consensus on reducing the size of the European Commission following the admission of Romania and Bulgaria could also have political repercussions on the revision project.

### External Influences

The European Union is increasingly perceived as an actor on the stage of international politics, and called on to fill out that role.<sup>19</sup> As a result the challenges faced by the EU grow along with the responsibilities and expectations placed upon it. If the Union is to adopt an active, policy-shaping role in the "globalised world,"<sup>20</sup> it must do more than develop institutionally; it also requires corresponding financial resources both for the common foreign, security, and defense policies, and in the form of increased investment in fields such as promotion of innovation and research.

<sup>19</sup> See also Communication from the European Commission, *Europe in the World—Some Practical Proposals for Greater Coherence, Effectiveness, and Visibility*, COM (2006) 278 final, June 8, 2006.

<sup>20</sup> Communication from the European Commission, *European Values in the Globalised World*, COM (2005) 525 final, October 20, 2005.

The need for funds grows automatically as the tasks increase and new fields of policy become Europeanized. For example, the issue of immigration at the EU's external borders is growing in importance, and with it the challenge of responding jointly to this problem of the Mediterranean states.

Resuming the WTO Doha round—for which European agricultural policy proved to be one of the stumbling blocks—is without doubt of central importance for the revision of EU spending policy. If the European producers of agricultural products are, as desired, to remain competitive in global agricultural markets, then the CAP must continue its shift to direct income support for European farmers (unlinked to production). Continuing and indeed speeding up reform of the Common Agricultural Policy is a fundamental precondition for reviving or continuing the Doha round. In this way the WTO talks could yet again act as a catalyst for reforming the CAP.<sup>21</sup>

Alongside these challenges of global policy, to which the EU and its member states will have to find adequate responses, there are also decisions in the pipeline where the EU can determine the budgetary consequences itself. The most important fundamental decision for the further development of the EU Financial Framework will undoubtedly be the admission of new members.<sup>22</sup> In particular the decision to commence membership negotiations with Turkey is portentous in this connection, because Turkish membership of the EU would further exacerbate the socioeconomic disparities within the Union. According to the European Commission, the magnitude of the burden would be comparable to the effects of the

<sup>21</sup> Peter Nedergaard, "The 2003 Reform of the Common Agricultural Policy: Against All Odds or Rational Explanations?" *Journal of European Integration* 28, no. 3 (July 2006): 203–23.

<sup>22</sup> European Parliament, *Report on the Consequences of Future Enlargements on the Effectiveness of Cohesion Policy*, rapporteur Markus Pieper, A6-0087/2007, March 28, 2007.



admission of ten new members on May 1, 2004.<sup>23</sup> Simply increasing the volume of the EU's budget is not an option. Even if only for this reason, the plans to admit Turkey should exert additional pressure for reform of the EU's finances and budget.

### Changes within the EU and Its Member States

The strongest effects on the revision process will certainly be those arising from domestic political changes and changes of government in important EU member states. The election of a new French president and a new British prime minister will be especially important. The conflicting national interests of France and Britain were central to the failure of the first attempt to reach a compromise on the Agenda 2007, under the Luxembourg Presidency in 2005. And it is highly probable that these two member states will also polarize the revision negotiations, especially given that their respective positions are articulated pretty openly in the rendez-vous clause. Any change of position by the political leaders in Paris and London will therefore impact on the revision process. France's strong concentration on the French farmers and their lobby could weaken when President Jacques Chirac leaves office. At least in a European policy speech in Brussels on September 8, 2006, the new president, Nicolas Sarkozy, called for ambitious reforms of the EU funding system (without specifically mentioning the Common Agricultural Policy).<sup>24</sup> At the

<sup>23</sup> Estimates for the EU Structural Funds suggest annual costs of around €13,500 million; various studies put the annual cost for the CAP at more than €8,000 million. The European Commission's impact study of the possible implications for the CAP of Turkish EU membership came to the conclusion that after possible transitional periods lasting until 2025, the annual cost of full direct payments and market expenditure at today's prices (2004) could be €5,300 million and €660 million respectively, see European Commission, *Issues Arising from Turkey's Membership Perspective*, working document, Brussels, October 6, 2004, SEC (2004) 1202; see also Wolfgang Quaisser and Steve Wood, *EU Member Turkey? Preconditions, Consequences and Integration Alternatives*, Forst Arbeitspapier no. 25 (Munich, October 2004); similar Kirsty Hughes, *Turkey and the European Union: Just Another Enlargement? Exploring the Implications of Turkish Accession*, Friends of Europe Working Paper (Brussels: Friends of Europe, June 2004).

<sup>24</sup> Sarkozy characterizes the present system as follows: "Il est illogique, injuste, insupportable pour les pays contributeurs nets et incompréhensible pour les citoyens."

same time he proposed creating an autonomous source of revenues for the EU and announced that this issue will be one of the priorities for the French Council Presidency in the second half of 2008.

In the United Kingdom Tony Blair's resignation could lead to a consolidation of reform-skeptical positions. The compromise of December 17, 2005, included a small adjustment to the British budget rebate and immediately drew criticism of Blair's negotiating strategy from the Brown camp. So there is reason to believe that Blair's designated successor is unlikely to show much willingness to compromise, at least on the question of the British rebate—especially given that with an eye to the general election due in 2009 or at the latest in 2010 Gordon Brown will want to avoid giving the Conservatives any opportunity to conduct a Euro-skeptic or nationalist/populist election campaign.

Upcoming elections in other EU member states and the potential ensuing domestic political changes could also bring with them policy shifts; but they are unlikely to have the same impact on the course of negotiations as the leadership changes in Paris and London.<sup>25</sup>

The same cannot, however, be said of the consequences of the 2009 elections to the European Parliament and the subsequent appointment of a new European Commission. The European elections will redefine the composition of an important institution that has insisted—early and loudly—on a proper hearing and a "clearly defined role" in the reform process.<sup>26</sup> The appointment of the Commission President is also closely tied to the outcome of this election. The appointment of the current Commission President, José Manuel Barroso, was already conducted under the new rules of the constitutional treaty, according to which his party-political allegiances should respect the majority in the European Parliament. Under this procedure the selection of the Commission President in 2009 would also have to follow the outcome of the European Parliament elections. Because appointments at the European level are often tied to important policy decisions, this

<sup>25</sup> Parliamentary elections are scheduled for 2007 in Estonia and Finland, and for 2008 in Greece, Lithuania, Malta, Slovenia, and Spain.

<sup>26</sup> European Parliament, Committee on Budgets, *Working Document No. 3 on Financial Perspective 2007–2013: EP Key Points for the Negotiations with the Council Based on the European Parliament's Negotiating Position of 8 June 2005*, PE 367.953v01-00, January 26, 2006.

appointment—the EU’s most important—could also become part of a broader overall package.

The admission of two new member states, Romania and Bulgaria, means that the protocol to the Treaty of Nice concerning the enlargement of the European Union comes into effect, and this will be of outstanding importance for the course of the revision process. Article 4 of the protocol states that when the Union has grown to twenty-seven or more members, “the number of Members of the Commission shall be less than the number of Member States.” That means that for the first time some EU members will have to do without nominating “their” commissioner. The sole criterion for selecting commissioners will then be a principle of rotation under which all member states will get an equal turn, and the Commission will in future be appointed in such a way that “each successive college shall be so composed as to reflect satisfactorily the demographic and geographical range of all the Member States of the Union.” As of 2009 it will only be possible to resolve the question of the composition of the Commission in the context of all the personnel and policy issues in the EU. Accordingly, the way the revision negotiations coincide with unpostponable personnel appointments will probably also lead to linking of policy and personnel issues in the discussion of reform of the EU’s financial constitution. Those member states that do not nominate a commissioner will expect compensation in other fields of policy.

## Reform of Spending Policy

The EU's spending policies are currently determined by two major areas of expenditure: the Common Agricultural Policy and the Structural and Cohesion Policy. In the now finalized Financial Framework for 2007–13 the EU reserves about 70 percent of its resources for these two areas. This controversial concentration on primarily redistributive policies cements the EU's imbalanced spending policies for the coming years. Although all the member states say they want to shift spending priorities to allocative policies and modernize the EU budget, and although all the EU institutions repeatedly point to the new challenges for the Union and have committed themselves to ambitious goals, in the recently concluded funding negotiations it still proved impossible to agree on fundamental structural reforms. Plainly the forces of inertia were stronger than the desire to change course.

The cause for this resistance to change lies in the tangible influence of those interest groups that profit from the present redistributive structures, in particular the farming lobbies and the most backward regions of the EU. Other reasons for the continuing misallocation of the EU's resources are to be found in the institutional distribution of responsibility and in the complex negotiating processes, but above all in the tenacity with which national governments stick to the ideological categories of the "juste retour" and the net balance.

The existing EU funding system contains a series of incentives for the EU institutions to reinforce their inherent institutional interests. Because the European Parliament bears no responsibility for funding the EU budget but nonetheless is naturally interested in expanding its political remit, it is easy for MEPs to call—as they often do—for new and expensive EU programs. The European Commission, too, attempts to expand its radius of action beyond the powers allocated to it by enlarging expensive EU programs.<sup>27</sup> By contrast, the member states in the Council, which fund the EU budget through their contributions, are

<sup>27</sup> The same behavior can also be observed in some ministerial councils. Heads of departments often attempt to increase their political (and thus financial) weight within their own government and its domestic policy through coordination with their colleagues from other member states.

always particularly interested in restricting spending and maintaining budgetary discipline.

The complex negotiating situation and the principle of unanimous decision-making have to date tended to exacerbate these conflicts between the EU institutions and the member states. In order to find a compromise at all, the last resort has generally been simply to increase the volume available for distribution. The EU budget has also often been used to push through major political integration projects, where the potential losers of an integration measure were compensated for their assent by payments from the EU budget.<sup>28</sup> An important consequence of these side payments was that the redistributive part of the EU budget expanded. The danger grew that the EU would become even more a transfer union.

So in order for the EU budget structures to be thoroughly overhauled, a political decision to rethink the EU's spending priorities is required. At the center of this debate we often find the concept of European "added value."<sup>29</sup> Both the Commission and the member states too have attempted to use the latest round of negotiations for a discussion about a possible European added value of the common policies.<sup>30</sup> In its

<sup>28</sup> Cay Folkers, "Welches Finanzausgleichssystem braucht Europa?" in *Regionalentwicklung im Prozeß der Europäischen Integration*, ed. Helmut Karl and Wilhelm Henrichsmeyer (Bonn, 1995), 87–108.

<sup>29</sup> Daniel Tarschys, *The Enigma of European Added Value: Setting Priorities for the European Union*, SIEPS Report no. 4/2005 (Stockholm, June 2005).

<sup>30</sup> The Commission defined the assessment criteria for "European added value" in its communication on Policy Challenges and Budgetary Means of the Enlarged Union 2007–2013 of February 10, 2004, in order to justify its proposed spending increases. It defined the added value as follows: "The Union's value added lies in transnational and Europe-wide action. Here, national authorities are ill-equipped to take into account the full benefits or costs of their actions. Effectiveness requires large critical masses beyond the reach of national governments alone, or in networking efforts made at national level. Common policies, as established by the Treaties, can deliver these benefits, through a mix of regulation, coordination, and financial resources." European Commission, *Building Our Common Future: Policy Challenges and Budgetary Means of the Enlarged Union 2007–2013*, COM (2004) 101 final, February 10, 2004, 5.

conclusions of December 16/17, 2004, the European Council was already calling for all the EU's finance-related measures not only to comply with the general principles of subsidiarity, proportionality, and solidarity, but also to produce added value too.<sup>31</sup> Although in their analysis of the Commission's proposal for a new Financial Framework the member states were in most cases able to agree with the goals and the statement that a general added value existed, putting an exact figure on the value was always controversial. But when the first proposal for an overall compromise (the "negotiating box") was presented, if not before, the added value debate was again drowned out by the net payer logic and status quo thinking of the individual states.<sup>32</sup>

Nonetheless, the EU partners should resume and deepen their exploration of a possible political and economic added value of common policies independently of the question of funding systems and the associated calculation of net balances. Ideally the revision debate should lead to general, objective criteria by which a European added value could be defined and measured. This would provide a basis for weighting tasks that would allow the limited European resources to be distributed more effectively. This could lead to success in breaking open the outdated status quo of European spending policy and to re-examination of the current priorities. It would also make sense to differentiate within the policy areas where more intensive funding from the EU budget is under discussion. For example, in the EU research program, listing specific pure research fields and projects that have a common added value but are

<sup>31</sup> Although in the further course of the Agenda 2007 negotiations the member states intensively discussed the added value of each individual field of policy, at the same time the validity of this assessment method was clearly hedged: "Whereas examination of the European added value of proposed expenditure is accepted as an essential part of the evaluation exercise, it was pointed out that this concept could not be based on entirely objective criteria; it is also generally recognised that the concept of added value should serve not to call into question Union policies which are based on fundamental agreed principles laid down in the Treaty but simply to evaluate the best means of achieving a given objective." Council of the European Union, *Progress Report from the Presidency to European Council, Subject: Financial Perspectives 2007-2013*, doc. 16105/04, December 14, 2004, item 7c.

<sup>32</sup> The best example is the new European Globalization Adjustment Fund, which should be interpreted less as proof of an orientation on mutual European added value than as a sign of the continuity of the compensatory function of the EU budget.

beyond the means of the nation-states. Other conceivable examples include the synergy effects that could be expected from a coordinated European arms policy, coordination of development priorities and activities (which could both produce budget savings and enhance European development policy in third states), or transferring more responsibilities in the field of migration and asylum to the EU.

The future handling of the European Commission's transparency initiative will be important for the reform process.<sup>33</sup> In its green paper the Commission included demands made by certain organizations such as Transparency International and the internet platform farmsubsidy.org and put the idea of publicizing information about the recipients of EU funds up for discussion. In the case of agricultural and regional subsidies, publishing the level of individual subsidy payments and the names of the beneficiaries could trigger a public debate about the appropriateness and volume of the Common Agricultural Policy and the European Structural Policy.<sup>34</sup> In any case, if openness became obligatory this would improve the possibilities for drawing conclusions about the precision with which subsidies are targeted and the effectiveness of the payments.

All in all, a fast and complete conversion of the EU funding system from a redistributive system to a strictly allocative one is not to be expected. Although the EU budget will continue to have to fulfil redistributive and compensatory functions, the 2008/09 revision should at least be used to discuss and agree general principles, especially the goal of promoting European added value. The later funding negotiations should then focus on these points.

## Possibilities for Reforming the Common Agricultural Policy (CAP)

The European Common Agricultural Policy has always been an issue whose importance extended way beyond the regulation and financing of this sector of the economy. For all the justified doubts and criticisms, the CAP can be regarded as a very successful community policy. But its success by no means obviates the need

<sup>33</sup> Commission of the European Communities, *Green Paper: European Transparency Initiative*, COM (2006) 194 final, May 3, 2006.

<sup>34</sup> Precisely this intended consequence was the reason for the initiative's rejection by the German Bundesrat and for the open skepticism of the German government.

to scrutinize its goals and to re-legitimize the CAP. On the contrary, the question remains justified as to why a relatively small branch of the economy with a relatively small share of employment has to be continuously and disproportionately subsidized through the community budget—and in a context where the distribution criteria are intransparent, in no way conform to the idea of community solidarity, and farmers are not always subsidized equally and appropriately.<sup>35</sup>

In its reform initiatives to date the EU has been pursuing the twin goals of maintaining and consolidating the multifunctional European agricultural model while at the same time making European agriculture internationally competitive.<sup>36</sup> Both require agricultural reform to continue, which means decoupling direct payments from production and further liberalizing the agricultural markets.

To date, however, reform of the CAP has neither succeeded in noticeably reducing the dominance of agricultural spending in the EU budget nor in silencing criticism of the CAP at the world trade talks. Plainly the point currently reached in reform of European agriculture is insufficient. Even the initiatives to define new goals and tasks (such as protecting the environment and rural areas) also serve primarily to justify the continuation of subsidies. Although it is argued that the EU payments reward a service provided to society by farmers, neither the stronger focus on supporting rural areas nor the environmental and animal welfare motives of the cross-compliance rules are really convincing. Like their predecessors, these new instruments of the multifunctional European

agricultural model exist primarily to justify distributive political goals. Only to a limited extent are they about a European added value that needs to be funded from the EU budget, especially as there is no transparent comparison of the costs of these new services with the payments made for them out of the EU budget.

Agricultural policy was bracketed out of the Agenda 2007 at an early stage. During the last funding negotiations no government really dared to question the compromise reached between Chancellor Gerhard Schröder and President Jacques Chirac in October 2002, in advance of the eastern expansion.<sup>37</sup> Only the European Parliament, in its resolution of June 8, 2005, called for the system of cofinancing to be applied to the CAP too. Although funds for market expenditure and direct payments will in the 2008 budget for the first time cease to be the largest spending item (superseded by spending on growth and employment), the very fact that what was still the biggest spending item in the EU budget was bracketed out of the round of negotiations that has just been completed could now make the CAP a choice target for reform in the upcoming revision phase.

Furthermore, the need to restructure and legitimize the CAP will be considerably increased by external pressure for reform generated by the WTO Doha round and the public discussion about the appropriateness and effectiveness of European subsidies. All the EU agriculture ministers are plainly aware of this political pressure because at their informal meeting on September 26, 2006, in Oulu, Finland, they agreed to energetically defend the European agricultural model in the revision debate.<sup>38</sup> The shared interests of the national agriculture ministers and the Directorate-General for Agriculture make it very unlikely that the CAP will be fundamentally changed, still less completely abolished, especially given that the latter would require an amendment to European primary law.

<sup>35</sup> Richard Baldwin, *The Real Budget Battle*, CEPS Policy Brief no. 75 (Brussels: Centre for European Policy Studies, June 2005); Richard E. Baldwin, *Who Finances the Queen's CAP Payments?* CEPS Policy Brief no. 88 (Brussels: Centre for European Policy Studies, December 2005). Currently only the three Scandinavian member states publish detailed information on recipients of CAP funds, see [www.farmsubsidy.org](http://www.farmsubsidy.org).

<sup>36</sup> Since the McSharry reform of 1992 (and the subsequent Fischler reform of 1999 and the Luxembourg reform of 2003) the CAP has been subject to a continuous process of revision and adaptation at the center of which is the separation of direct income subsidies for farmers from the production of agricultural products. The CAP's subsidy policy has gradually shifted from protectionist production-linked price support policies to direct income subsidies paid to farmers. The latest reform (the Luxembourg reform of 2003 also makes direct payments conditional on the observance of European and national standards for environmental protection, animal welfare, food safety, and health and safety at work (cross compliance) and increases funding for the second pillar of the CAP, rural development (modulation).

<sup>37</sup> The agricultural compromise proposed freezing spending on agricultural direct payments and price support until 2013 with only a one-percent inflation adjustment. Under it, the new member states will move slowly in predefined steps into the direct payments system. The only amendment to this agricultural compromise during the Agenda 2007 negotiations was that additional funds will have to be found in the agreed budget for integrating Romania and Bulgaria in the CAP.

<sup>38</sup> Finland's EU Presidency, *The European Model of Agriculture – Challenges Ahead: A Background Paper for the Meeting of Ministers of Agriculture in Oulu 26.9.2006*.

Nonetheless, for the revision negotiations the situation of the CAP will still be different to before. Not only that there will be no prior decision on setting or capping the level of this spending item; more importantly, there will be further reforms in the first pillar of European agricultural policy, i.e. in the field of direct payments and price support regimes. Following reform of the sugar regime, reform of the wine regime is already under negotiation, and completion of the overhaul of all the price support regimes is planned for 2009. Then the first pillar of the CAP will comprise almost exclusively direct payments to European farmers.

There are few differences over the general goals of the next reform steps. Even the “vision” for a reformed CAP published by the British Treasury lists the familiar elements of the multifunctional European agricultural model as goals for reform: improving international competitiveness, producing good, high-quality food, observing high environmental standards, security of employment, observance of animal welfare standards, and compliance with WTO rules.<sup>39</sup> So overall the CAP is to be oriented more clearly on free-market principles. As well as observing the fundamental rules of competition this would also involve further cutting subsidies and abolishing market protection by reducing import duties. The goal of this policy should be to improve European agriculture’s international competitiveness and ability to flourish on the global markets.

On the basis of existing community law a first reform step could involve a further shift of EU resources from the direct payments sector in the first pillar to the second pillar of the CAP (rural development). Today it is already clear that the European Commission sees this shift as a central element for further reform of the CAP. For 5 percent of direct payments this “modulation” has already been agreed and finalized between the member states. Additionally, the scope for facultative modulation will also be expanded. The Commission has proposed allowing each member state to cut direct payments by up to 20 percent and to use the funds thus released for rural

development.<sup>40</sup> This shift of EU resources would make it possible to invest more strongly in rural economic and social development (for example through funding early retirement, farm modernization, training programs, new marketing concepts, etc.) instead of subsidies in the form of direct payments.

However, the “Memorandum on the implementation and the future of the reformed CAP” published by the main beneficiaries of the CAP showed clearly how difficult it will be to proceed with even limited CAP reforms.<sup>41</sup> In the memorandum a group of twelve member states state their limits for the coming reform debate. Although they declare their willingness to accept administrative simplification of the CAP and new managerial and regulatory measures (to the extent that these secure the income of European farmers and help to defend the European agricultural model) the document makes no mention of reducing the budget funds reserved for the first pillar of the CAP by reducing subsidies nor the question of lowering import duties. Instead the twelve member states now also subsume regional diversity, agricultural traditions, agroenvironmental considerations, and typical local agricultural products under the protection-deserving multifunctional European agricultural model.

Germany has a key role to play when it comes to reforming the Common Agricultural Policy.<sup>42</sup> On the one hand, as the biggest net contributor to both the EU budget and the CAP, Germany has an interest in minimizing the costs of European agricultural policy. On the other, Germany pursues a considerate policy course toward the CAP’s biggest beneficiary, France, when it comes to tangible cuts in the EU’s agricultural budget. The German government is continuing a poli-

<sup>40</sup> European Commission, *Proposal for a Council Regulation laying down rules for voluntary modulation of direct payments provided for in Regulation (EC) No 1782/2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers, and amending Regulation (EC) No 1290/2005*, COM (2006) 241 final, May 24, 2006.

<sup>41</sup> Memorandum presented by the French, Greek, Spanish, Irish, Italian, Cypriot, Lithuanian, Luxembourg, Hungarian, Polish, Portuguese and Slovenian delegations, and endorsed by Romania and Bulgaria. Document of the Council 7265/1/06 rev. 1, March 17, 2006.

<sup>42</sup> See also Jack Thurston, “Why Europe Deserves a Better Farm Policy,” *Centre for European Reform Policy Brief*, December 2005.

<sup>39</sup> HM Treasury, *A Vision for the Common Agricultural Policy* (London, December 2005), [www.defra.gov.uk/farm/capreform/pdf/vision-for-cap.pdf](http://www.defra.gov.uk/farm/capreform/pdf/vision-for-cap.pdf).

cy oriented on the status quo.<sup>43</sup> But of course Germany also has national interests of its own when it comes to reform of the CAP. The idea of setting an upper limit for payments to individual farms and introducing a degressive scale of payments by size of farm, revived by Agriculture Commissioner Mariann Fischer Boel in June 2006,<sup>44</sup> would have hit the big farming enterprises in eastern Germany hardest (and to a lesser extent the few large farms in the United Kingdom).<sup>45</sup> For that reason the German government has consistently rejected this proposal.

The first starting point for reforming the CAP remains making greater use of the instrument of cofinancing, especially where the new member states were granted the option of facultative cofinancing of direct payments in the accession negotiations.<sup>46</sup> The additional increase in budget funds in the cofinanced second pillar of the CAP for rural development (modulation) will only produce the desired savings if there is a corresponding cut in funding in the non-cofinanced first pillar. There is no reason why direct payments to farmers should not be cofinanced. This mode of funding is normal in European Structural Policy and would by no means automatically lead to the renationalization of a communitized field of policy (the doom warning always conjured up by France). Instead, this procedure could lead to stricter budget discipline and more efficient application of EU funds. In a second step the share of the EU budget spent on the first pillar of the CAP should be reduced still further. This will be unavoidable if funds are to be released that are needed for allocative policies.

<sup>43</sup> The coalition agreement of November 11, 2005, between the German social democratic and Christian democratic parties (SPD and CDU/CSU respectively) stated that “Reform of agricultural policy will continue its existing course” (p. 128).

<sup>44</sup> George Parker, “Big Landowners to Lose Millions in EU Reform,” *Financial Times*, June 6, 2006.

<sup>45</sup> The Commission’s repeated proposal to introduce a cap of €300,000 per farm would have very little effect on the budget as a whole and would above all one-sidedly affect the agricultural sector in two member states (eastern Germany and Great Britain). It is also likely that ways would be found to get round the maximum size rule, for example by artificially dividing farms, which would further minimize the saving for the EU budget.

<sup>46</sup> This is because the new member states are only slowly being “phased into” the direct payments system. In 2007 farmers in the new member states will receive 40 percent of the level of direct payments received by their EU15 colleagues; the rate will then be raised by 10 percent each year until 2012. However, the new member states are allowed to augment the EU direct payments from their national budgets.

## European Structural Policy

According to Article 158 of the Treaty Establishing the European Community, the purpose of European structural and cohesion policy is to counteract the different levels of development in the different regions of Europe and in particular to reduce the development gap in regions that are structurally weak in relation to the EU average through deliberate measures (goal of convergence), in order to increase economic and social cohesion in the Union (goal of cohesion). The basic regulation for the European Structural Funds, which defines the goals and spending priorities, has to be agreed unanimously. As a consequence of this compulsion to reach unanimous decisions, the Structural and Cohesion Policy generally follows the status quo. This narrows the room for reform, allowing no more than modifications on the basis of the lowest common denominator.<sup>47</sup> Another inhibition to reform is that European Structural and Cohesion Policy is the most visible example of the compensatory function of the EU budget and as such fulfils an integratory function over and above the actual field of policy itself.<sup>48</sup>

The starting point for the negotiations for the funding period beginning 2014 will be fundamentally different from that for the round of negotiations that has just finished. For the first time, through Article 161 of the Treaty Establishing the European Community, European treaty law provides for the possibility of qualified majority voting on the goals and distribution of funds. But because the overall budget of the Financial Perspective—and with it the financing available for the Structural Funds—still has to be agreed unanimously, the impetus for reform provided by the introduction of majority voting in the statutory instruments of the Structural Funds remains limited. This modification of the mode of voting could be used

<sup>47</sup> Wolfgang Petzold, “Zur Debatte und den Perspektiven der EU-Strukturpolitik nach 2006,” in *Solidarität und Beitragsgerechtigkeit: Die Reform der EU-Strukturfonds und die Finanzielle Vorausschau*, ed. Ines Hartwig and Wolfgang Petzold, 117–35 (Baden-Baden, 2005).

<sup>48</sup> The establishment of the European Regional Development Fund (ERDF) in 1975 can be traced back to Britain’s insistent urging for compensation for the underdeveloped British agricultural sector and the resulting low level of receipts from the EU budget. The southern expansions of 1981 and 1986 (Greece, Spain, and Portugal) led to a doubling of the Structural Funds, and the price of agreement on European currency union in the Maastricht Treaty was compensation for the most backward member states in the form of the European Cohesion Fund.

for technical adjustments under the legislative procedures. This reduces the veto options of individual states, and as a result the chances of changing spending priorities should be improved.

Working on the assumption that existing European primary law cannot be changed in the course of the revision debate, two central pillars of EU Structural Policy become immutable, causing certain of the reform options discussed in advance to be excluded:

1. Anchoring regional cohesion in Article 158 of the Treaty Establishing the European Community excludes the possibility of fundamental change to the system, for example a transition to a generalized European financial compensation system between member states in the sense of a net fund model.<sup>49</sup>
2. At the same time, the goal and purpose is still to reduce the differences in development between the regions and reducing the disadvantage of the most backward regions in the EU with the assistance of subsidies from the EU budget (Article 3, paragraph 1, item k and Article 158 of the Treaty Establishing the European Community).

This means that the revision debate can discuss only modifications within the existing system, because a system change would mean changing the treaties. At best the negotiations could be used to conduct an open and non-binding exchange of views on the advantages and disadvantages of the much-discussed system change.<sup>50</sup>

Closely connected with the question of the financial volume and funding objectives and concepts of the European Structural Funds is the question of how and to what ends these funds may be spent in the form of

European regional subsidies.<sup>51</sup> In spring 2006 the Commission revised its guidelines on national regional aid.<sup>52</sup> Regional aid serves primarily to support businesses investing in new plant and thus creating jobs and thus to promote economic, social, and territorial cohesion within the EU without competition-distorting effects at the expense of other regions (such as subsidy-led business relocations and associated loss of jobs). Overall, the level of regional aid (investment subsidies for large companies and under certain circumstances operating subsidies) has been significantly reduced and restricted across Europe.<sup>53</sup>

Nonetheless there is still criticism that the subsidy gradient between the old and new member states is too large and offers incentives to relocate plant in order to benefit from subsidies.<sup>54</sup> European Structural

<sup>51</sup> The granting of aid under Article 87, item 3a of the EC Treaty (aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment) is restricted to the current Objective 1 regions and the granting of aid under Article 87, item 3c of the EC Treaty (aid to facilitate the development of certain economic activities or of certain economic areas) to Objective 2 regions.

<sup>52</sup> "Guidelines on National Regional Aid for 2007–2013," *Official Journal of the European Union* March 4, 2006: C 54/08, and "Draft Commission Regulation on the Application of Articles 87 and 88 of the EC Treaty to National Regional Investment Aid," *Official Journal of the European Union*, May 20, 2006: C 120/02. See also Fiona Wislade, *Plus ça change, plus c'est la même chose? Recent Developments in EU Competition Policy and Regional Aid Control*, European Policies Research Paper no. 58 (Glasgow: University of Strathclyde, November 2005).

<sup>53</sup> For the eastern German Objective 1 regions the nominal maximum levels of subsidy fall from 35 percent to 30 percent, although supplements are permitted for small (+20 percent) and medium-sized businesses (+10 percent). For regions affected by the statistical effect (i.e. regions with a GDP only slightly above the threshold of 75% of the Community average because of the fact, that by enlarging the EU the average GDP decreased), the aid regime remains unchanged until the end of 2010; after that there will be an evaluation to decide whether the levels of aid can be reduced still further. In the new member states the level of aid will be reduced to 40 percent (in regions with GDP between 60 and 45 percent of the regional average) or 50 percent (in regions with GDP below 45 percent of the regional average). The nominal difference between permissible aid levels in the most backward regions of the old and new member states is thus 10 percent. The maximum aid rate for regions in western Germany is 15 percent of the total investment. Thus there is a "west-east subsidy gradient" graduated according to regional affluence.

<sup>54</sup> This problem is what led the German government to demand amendments to the aid guidelines in order to prevent job losses through company relocations using funds from the European Structural Funds. Ultimately, however, only mini-

<sup>49</sup> The formulation used in the EC Treaty has, incidentally, also been adopted in Article III-220 of the Treaty establishing a Constitution for Europe and consequently currently enjoys great legitimacy as a result.

<sup>50</sup> Anyway, the introduction of a generalized EU financial compensation system, where the Community's influence over spending priorities and control of earmarking would not be sufficiently guaranteed—and in particular not comprehensible to the net contributors—could call into question the fragile system of Community solidarity. The institutional framework of the Community would have to be readjusted because the European Parliament could only be given a limited role in defining national spending targets within that kind of generalized financial compensation system. The imbalance to the executive side of the system and the dominance of the national level would be still further strengthened to the detriment of the Community institutions and parliamentary participation.



Policy and state aid policy thus still face the challenge of helping the most backward regions without harming the more affluent and without setting off an aid and subsidy race. In future the scarcity of resources will necessitate an even clearer concentration of EU funds on the most genuinely backward regions of the EU27. This particular focusing of the aid priorities in European Structural Policy should, however, also be tied to greater subsidy flexibility for those regions that also suffer structural problems but are not necessarily dependent on aid from the EU budget.

Because the funding period of the Structural Fund programs coincides with that of the Financial Perspective we have the unusual situation that certain regions continue to enjoy aid programs from the EU budget even though on the basis of their positive economic development they would not actually be entitled any more.<sup>55</sup> The most glaring discrepancy between actual need and legal entitlement is Ireland, which still enjoyed the highest EU aid category until 2006 (albeit phasing out) despite its standard of living having risen considerably since the mid-1990s.<sup>56</sup> In order to exclude this temporary anomaly a clause should be inserted in the Structural Funds basic regulation for the aid eligibility of a region to be reviewed on the basis of updated statistical data at the middle of the aid period. This would open up the possibility to put a region in a transitional regime at an earlier stage (“phasing in” or “phasing out” rule).

One special feature of the Structural Funds system remains the “artificial” absorption limit of maximum 4 percent of GNI for allocation of funding. It would be conceivable to reduce the upper limit to 3 percent because that figure was never exceeded in the EU15 in the 2000–06 funding period; the highest share was achieved by Portugal, with grants amounting to 2.85 percent of its GNI.<sup>57</sup> However, in the round of negotiations just completed, Poland in particular actually urged for the cap to be raised, showing just

mal changes were achieved, such as raising the “de minimis” ceiling and tightening up the obligation of review of the aid-granting region.

<sup>55</sup> This yawning gap between need and entitlement is made still worse because the decision on a region’s eligibility is made on the basis of statistical data relating to a period between three and five years before the start of the actual subsidy period.

<sup>56</sup> However, Ireland is also the best example of successful use of the European Structural Funds.

<sup>57</sup> European Commission, *Capping of Resources*, Working Document of the Commission Services, Fiche No. 27, October 7, 2004.

how difficult it would be to lower the absorption limit. Nonetheless, in the revision negotiations another attempt should be made, especially given that the initial experience and current statistics suggesting a potentially insufficient flow of funds toward the middle of the 2007–2013 funding period might provide first indications and objective arguments for redefining the upper limit.<sup>58</sup>

In the negotiations over reform of European Structural Policy Germany has so far found itself in a dilemma. As a consequence of the disparity between the benefits the German *Länder* gain through European regional policy and the cost to central government of financing of the EU budget rather ugly internal conflicts erupted. The interests of federal and *Länder* governments diverge significantly here. Whereas the federal government would like to minimize Germany’s net contributions to the EU, the *Länder* have a great interest in maximizing their receipts from the EU budget. In the end this conflict was conducted at the European level, which for a time led to a weakening of the German negotiating position. With respect to the revision debate, Germany’s federal and *Länder* governments should coordinate their interests in good time. In this case federal government will probably only be able to satisfy the interests of the *Länder* in retaining European subsidies by promising national compensation before the negotiations begin.<sup>59</sup> A change in the German negotiating situation could also result from the circumstance that most of the eastern German regions should have “grown out” of the maximum EU subsidy category and only be receiving grants from the top category under the “phasing-out rule.”

So the continuing reform process will have to combine the goal of focusing funds with those of flexibility and subsidiarity. However, denationalizing structural policy measures remains excluded; instead it will become necessary for the different levels to cooperate more closely and for policies to be better coordinated.

<sup>58</sup> Incidentally, in the Agenda 2000 negotiations the German government was already calling for a lower absorption limit of 3 percent, see Bundesministerium für Wirtschaft, *Orientierungspunkte der Bundesregierung zur Revision der Europäischen Strukturfonds*, Bonn, March 4, 1997.

<sup>59</sup> Already during the last round of negotiations two net contributors, Great Britain and the Netherlands, adopted this strategy toward their own regions, in order to neutralize internal conflicts of interest.

## Corrections or Structural Reform for the EU's Own Resources System?

Even if the EU's sources of revenue are called "own resources," the Union still possesses no form of funding over which it is able to decide autonomously. European primary law currently neither defines the term "own resources" nor explicitly lists the different types of EU revenues; Article 269 of the EU Treaty merely defines the decision-making procedure. The form and mode of operation of the funding system are only laid out in more detail in the "own resources decisions."<sup>60</sup> These have to be approved unanimously by all the member states and ratified by their national parliaments. This passes the responsibility for the funding modalities and the distribution of financial burdens to the level of the nation-states.

In contrast to the situation on the spending side, this lack of primary law detail on the own resources system opens up the possibility of discussing and agreeing fundamental changes to the financing system during the 2008/09 revision debate. There are five potential places to start:

1. Abolishing all rebates and other exceptions in EU funding.
2. Introducing a generalized correction mechanism as an alternative to rebates, as already (unsuccessfully) proposed by the European Commission in advance of the Agenda 2007 negotiations.
3. Changing the funding modalities, i.e. the relative importance of the existing own resources.
4. Abolishing the VAT resource.
5. Giving the EU an autonomous own resource in the form of an EU tax.

If the member states really want to make the EU own resources system fair and transparent, the revision debate will have to address the problem of the British budget rebate and the exceptions and rebates

for the other net contributors. Although the formulations of the European Council of December 17, 2005, and the Interinstitutional Agreement of April 4, 2006, only mention the British budget rebate, it is likely that in the course of the debate the other exceptions will find their way onto the reform agenda too. The reason, of course, that abolition of these rebates was not possible in the latest round of negotiations was the rule that the own resources decision has to be adopted unanimously. This grants the respective beneficiary—especially the United Kingdom—a veto position. Much more important, however, is the open-ended validity of the own resources decision, which cements this status quo indefinitely. So the first step would have to be to give own resources decisions a time limit and to tie them to the Financial Perspective. It is, however, this very lack of expiry date that appears unrenounceable for the United Kingdom, because it is what gives the British their veto.

In 2004 the Commission initially proposed a generalized correction mechanism in order to gradually level out the United Kingdom's special position vis-à-vis the other net contributors and to share out the burden of contributions more fairly. But it proved impossible to implement this solution.

On the other hand, it would be relatively easy to achieve agreement on completely abolishing the VAT resource.<sup>61</sup> In the Agenda 2007 negotiations the Commission was already proposing completely abolishing the VAT resource, in order to link the national contributions to the EU budget more clearly to the wealth of individual member states. Because this source of funding has already been made inordinately complicated by a multitude of regulations and only a handful of experts in the national finance ministries and the

<sup>60</sup> The last own resources decision was passed on September 29, 2000: "Council Decision of 29 September 2000 on the system of the European Communities' own resources," Official Journal of the European Communities, October 10, 2006: L 253/42, 42–46. A new own resources decision, which should reflect the European Council's political understanding of December 17, 2005, is currently under negotiation; see European Commission, *Proposal for a Council Decision on the System of the European Communities' Own Resources*, working document, 2006/0039 (CNS), March 20, 2006.

<sup>61</sup> The VAT contributions come from the member states' national budgets but do not necessarily have to be financed out of the national VAT revenues. The contributions are calculated for each member state on the basis of a harmonized VAT base, where the level is capped by means of a maximum rate of call. The base for calculating the harmonized VAT resource is also restricted to 50 percent of the gross national product of the respective member state in order to compensate for the regressive effect to the detriment of the less affluent member states.

Directorate-General for Budget of the European Commission are able to calculate it, complete abolition of this resource would represent a big step toward more transparency and equity. However, precisely these complicated exceptions and calculation methods mean that gains and losses from the abolition of this resource would be unequally distributed.<sup>62</sup> In terms of the dominant net payer logic, the very intransparency and complexity of this resource are the reason it continues to appear attractive. Retaining the VAT resource means retaining instruments that allow negative net balances of individual member states to be compensated through targeted adjustments in the calculations. However, the overall volume that the additionally burdened member states would have to bear certainly appears reasonable in relation to the potential gains in transparency and efficiency. The prospect of achieving savings in administrative costs and the costs involved in calculating the VAT resource should make it easier to find approval for this simplification of the funding system.

Fundamentally, the ideal solution would be for the national contributions to the EU budget to be oriented on the respective affluence of each member state. Of course there will be debate about which method to use to calculate national prosperity: GNI per capita expressed in purchasing power standards (PPS) or GNI expressed in PPS. But it should still be possible to agree on the principle, even though some members—for example Ireland and the United Kingdom—would have to make a much greater contribution to funding the EU budget.

### A New Autonomous Own Resource

By concentrating decisively on the GNI resource and continuing to reduce the (already almost irrelevant)

<sup>62</sup> The Commission's calculations showed that fifteen member states with capped VAT bases would profit from abolition. These are the cohesion states Estonia, Greece, Ireland, Malta, Poland, Portugal, Slovenia, Spain, Czech Republic, Hungary, and Cyprus, as well as France, Great Britain, Luxembourg, the Netherlands, and Austria. All the other member states would have to expect to make higher contributions to the EU budget. Denmark would be the biggest potential loser if this change were made, with its share increasing by 2.66 percentage points or €45.9 million. Italy would be the biggest loser in absolute terms with its contribution to the EU budget potentially increasing by about €200 million, while Germany's contribution would also increase by 0.93 percentage points or €179.5 million.

traditional resources (customs duties and sugar levies) the EU would come closer to the usual funding systems of other international organizations of states. So the discussion about an autonomous source of funding is back on the agenda, especially given that the Commission has already announced that it will be making this question a central issue of the revision debate.

In the European Constitutional Convention there was already intense discussion of the legal possibility, the fiscal necessity, and the integrational desirability of a tax-based own resource. Agreement was reached that the legal possibility of introducing one existed, but opinions remained divided over whether an autonomous own resource was politically desirable, and the supporters were unable to win the argument. Belgium, France, Luxembourg, Austria, and Portugal, in particular, have been arguing for some years for an EU tax, while the majority of governments continues to fundamentally reject this argument.

The proponents of an own resources system based largely on tax revenues advance political as well as economic arguments.<sup>63</sup> Alongside the aspect of increasing the EU's financial autonomy, which is desirable from the point of view of integration, they stress in particular that this would improve the transparency and openness of the shared funding system for the European taxpayer. A more direct connection between the budget and the citizens would potentially increase the accountability of the EU's budgetary organs (Council and Parliament) to the Union's citizens. At the same time the necessity to democratically legitimize the EU's budget would increase, and in the long term this could lead to a broadening of the Union's legitimacy base as a whole. More strongly integrating the European Parliament and increasing its responsibility would shift MEPs' focus from spending policy more to the revenue side of the EU budget. This could also have a positive impact on European budget discipline, because increased cost transparency and budgetary responsibility could have a cost-damping effect. Overall the budget would

<sup>63</sup> Dieter Biehl, "Zur Reform der EU-Finanzierung: Braucht die Europäische Union eine eigene Steuerhoheit? Plädoyer für eine Reform der Finanzverfassung der Gemeinschaft," in *Die zukünftige Ausgestaltung der Regionalpolitik der EU*, ed. Wolfgang Gick, 29–54 (Munich, 1996); Klaus-Dirk Henke and Beate Milbrandt, "Die künftige finanzielle Lastenverteilung in der EU," in *Die Zukunft Europas im Lichte der Agenda 2000*, ed. Rolf Caesar and Hans-Eckart Scharrer, 119–35 (Baden-Baden, 2001).

be more clearly aligned on general European interests and on the mutual benefit of Community policies.

On the other side, the opponents of an EU tax always point to the great significance for the course of integration that would be associated with such a measure.<sup>64</sup> Introducing an EU tax would be a fundamental step on the path to European statehood, because the granting of fiscal powers is a significant characteristic of a federal financial constitution. An autonomous own resource would furthermore automatically trigger a new round of centralization, because one decisive precondition for introducing an EU tax would be Europe-wide harmonization of national tax regimes. But precisely this potential centralization is rejected by the proponents of competitive federalism, who hold that only competition between the different territorial bodies supplies incentives to limit the tax burden on individual citizens. And harmonizing or even centralizing the power to raise taxes would eliminate precisely that competition. This would lead, they say, to an inevitable softening of European budgetary discipline and to less efficient spending policies, and the EU tax would therefore serve primarily to give the European Union new scope for spending without increasing the burden on the national budgets. Despite claims to the contrary by the supporters, the opponents say, the European taxpayer would have an additional tax to pay on top of existing national, regional, and local taxes, and the consequences of this development for the future of the integration process would be questionable. Just because the costs of European integration were transparent and open for all its citizens must not necessarily mean that the European taxpayer would identify more strongly with the Union; on the contrary, this could actually further strengthen Euro-skepticism.

It will only be possible to implement an autonomous own resource for the EU if these arguments can be dispelled and in the long term both an increased

<sup>64</sup> For a summary see Friedrich Heinemann, *EU-Finanzreform 1999: Eine Synopse der politischen und wissenschaftlichen Diskussion und eine neue Reformkonzeption* (Gütersloh, 1998), 35ff; Wissenschaftlicher Beirat beim Bundesministerium für Wirtschaft und Technologie, *Gutachten zur Neuordnung des Finanzierungssystems der Europäischen Gemeinschaft* (Bonn, December 1998); Kurt Faltlhauser (Bavarian finance minister), *Einführung einer „EU-Steuer“?* (Munich, August 2001); Rolf Caesar, “Kein eigenes Besteuerungsrecht für die EU,” *Frankfurter Allgemeine Zeitung*, March 28, 2006, and lastly, Rolf Caesar, “Probleme und Perspektiven der EU-Finanzwirtschaft,” *Orientierungen zur Wirtschafts- und Gesellschaftspolitik* 108 (June 2006): 58–64.

burden on the taxpayer and an expansion of the EU Financial Framework can be dependably excluded. The system must be transparent and comprehensible and the role and responsibility of national governments and the European Parliament in raising or lowering taxes must be clearly identifiable for the taxpayer.<sup>65</sup> Given such publicity, the institutional interest of all the EU institutions in frugal budgeting and efficient use of funds would probably be greater. In the parliamentary debates over increasing taxes and spending, on the one hand, and tax reductions and efficiency increases on the other, those arguments that posit a potential European added value of joint measures and show that they are desirable and financially feasible should also gain more weight. This would shift the definition of European priorities and posteriorities to the center of the budget debates. The pressure to reform the EU budget would increase.

However, because the European Union has no fiscal administration of its own, the job of actually collecting taxes would remain the task of the national tax offices; in Germany this would be the job of the federal states, which are responsible for collecting taxes. This would open up two problems. Firstly, the national tax authorities would not share the tax revenues and might therefore have less interest in collecting a European tax than they would have in the case of a national tax. And secondly, in order to ensure fairness a uniform set of tax collection rules would have to be applied and observed. Otherwise those states that collected taxes consistently and reliably would place a heavier burden on their citizens than other states and would also contribute disproportionately to funding the EU budget. However, making the European tax a part of an existing national tax could resolve this problem.

So far the discussion has been dominated by those forces that are skeptical about an autonomous own resource. These are in particular the members of the national parliaments, who fear they would be held politically responsible for an increased tax burden on the citizens and would have to bear the costs alone in

<sup>65</sup> European Commission, *Financing the European Union: Commission Report on the Operation of the Own Resources System*, COM (2004) 505 final/2; Guido Raddatz and Gerhard Schick, *Braucht Europa eine Steuer? Zur Reform der EU-Finanzverfassung* (Berlin: Stiftung Marktwirtschaft, August 2003); Peter Becker, *Der EU-Finanzrahmen 2007–2013: Auf dem Weg zu einer europäischen Finanzverfassung oder Fortsetzung der nationalen Nettosalddpolitik?* S 36/05 (Berlin: Stiftung Wissenschaft und Politik, November 2005).

terms of poor election results or declining voter turnout. These reservations need to be neutralized by safeguard clauses and by an increase in transparency in the new system.

But because—after the extremely difficult negotiations and in view of the unwillingness to tackle reforms that has become apparent during their course—the task of thoroughly overhauling the revenue and spending sides of the EU budget still remains, both the opponents and the supporters of an autonomous own resource for the EU will be forced to consider the alternatives.

## Scenarios for the Revision Process

The primary purpose of a scenario is to describe potential developments and map out the spectrum of different alternatives, charting out various development trajectories on the basis of the existing data and analyses of the current situation. Such scenarios should be as internally consistent and coherent as possible. The fundamental goal when preparing scenarios should be to allow policy guidelines to be formulated and defended, in order to forecast the favored future development and if necessary to respond if changes in the political environment occur. Scenarios should therefore name the opportunities and risks and thus make it easier to choose specific national policy guidelines that can then in turn be operationalized during the negotiating process.

In the context of the given variables, the formal framework, the probable main negotiating topics, the history of the Agenda 2007 negotiations and the positions revealed there, and the relevant external influences, two scenarios are described here. They form the basis for drawing up the guidelines on which the operationalization of German policy on Europe should be orientated.

### The Status Quo Scenario

In this scenario the forces of inertia in the member states prevail over realization of the necessity to overhaul the system. The positions on proposals for reform known from earlier rounds of negotiations remain decisive and thus suffocate almost every initiative for change. The member states continue to measure every reform proposal and every deviation from the status quo (i.e. from the outcome of the Agenda 2007 negotiations) by its effect on their own national net balance. Discussion of the substance of spending priorities and equity in contributions is overshadowed by “juste retour” thinking and the net payer logic. One indication that this scenario certainly has the potential to become reality is the way the outcome of the Agenda 2007 negotiations has come to be viewed as a success in many member states and as proof of the expanded Union’s ability to act and agree under difficult economic conditions.

The rendez-vous clause would thus become a non-binding preliminary to the new round of negotiations for the Financial Framework 2014–2020 due to begin in 2011; the financial table laid down in the Inter-institutional Agreement would not be questioned. Because the rendez-vous clause specifies neither a fixed final date nor the form of the outcome, there would be no pressure to work toward any particular goal. The member states would in the main only formulate fundamental positions and would do all they could to avoid restricting their room for maneuver, because the real negotiating phase would be yet to come. From a tactical point of view any premature revelation of national positions or indication of a conceivable concession would be counter-productive, because this would only reduce the national negotiating flexibility. There would then be a risk of being unable to respond flexibly in the coming budget negotiations.

So the revision phase would be without any real dynamism of reform and negotiation. At best, pressure to adapt the system to its changing environment in a number of points could come through external pressure, for example the necessity to conduct further-reaching restructuring of the CAP as part of the WTO negotiations or through the conclusion of accession negotiations with Turkey and the resulting increased burden on the EU budget. The system itself—i.e. the dominant role of the member states in defining the EU’s revenues, the predominance of the European level in spending matters, and the logic of thinking in net balance categories—would in no way be called into question.

One conceivable outcome of this scenario would be a declaration of the European Council that was kept as non-committal and vague as possible, avoided anticipating the next round of negotiations, and allowed the member states to keep all their negotiating options open.

### A Reform Scenario of Limited Adaptation

In this scenario, too, the existing European funding and budget system is in no way called into question,

but here all the actors are convinced that it needs reforming. The harsh criticism that was often heard directly after the difficult conclusion of the Agenda 2007 negotiations gives rise to a general willingness to reform that leads to a structural overhaul and a far-reaching modernization of the EU budget on both the revenue and spending sides. National interests and net balance concerns are outweighed by the common goal of strengthening the European Union and guaranteeing its capacity to act. The basic consensus is that the EU should be given sufficient resources in order to be able to carry out the tasks entrusted to it efficiently.

However, the actors' fundamental willingness to work on reforms does not mean that the member states cease to pursue national calculations nor that the Commission and Parliament cease to introduce institutional interests of their own into the negotiations. But the shared ambition to achieve a lasting medium-term outcome that is more than the lowest common denominator promotes willingness to compromise on all sides and generates the necessary impetus for reform.

Here the criterion of European added value would for the first time become the real measuring stick for determining spending priorities. For that reason, during the revision negotiations the EU partners agree first on a shared definition of the challenges faced by the Union and its member states. On the basis of the report of the European Commission they then determine, in a second step, the tasks the EU is to take on. But the decisive point is that these duties are weighted, i.e. classified into higher- and lower-priority, and the spectrum as a whole is restricted qualitatively. Only then do the negotiations on funding for EU policies take place, which must then follow the set priorities. Here too, spending will have to be weighted and prioritized in order to meet the shared goal of strict budgetary discipline. The CAP (which was completely exempted from reform pressure during the Agenda 2007 negotiations) becomes the most important target for reform measures. Beginning with a very small (largely symbolic) cofinancing rate for direct payments to European farmers, a successful start is made with a new funding system. In the medium term the Financial Framework is developed into an integration policy planning instrument that increases the political controllability of the EU over and above pure budget policy. Although on the revenue side it is not possible to begin making the EU financially independent from the financial contributions of the member states, at least the discrepancy between the net contributors is

reduced through the introduction of a generalized correction mechanism. Thus an important step is taken toward a fairer contribution system, especially since the correction mechanism is tied to the abolition of all rebates and exceptions on the revenue side. At the same time the VAT resource is abolished and the GNI resources are more clearly than before orientated on the national prosperity of the member states.

The two scenarios described here not only represent the spectrum of possible outcomes to the negotiations: from the dominance of status quo thinking to the realization that reforms are necessary; it also offers a framework within which we can group the member states and the EU organs, and their negotiating goals and interests. At the same time the scenarios illustrate the close connection between the choice of process and the ultimate goal of the revision process. Depending on an actor's chosen goal in the negotiations, he will argue for or against giving the revision debate structure and targets at an early stage. So the supporters of the status quo will attempt to keep the debate vague and non-committal for as long as possible, while the proponents of reform will try to push the process quickly toward a comprehensive revision of the EU's financial constitution.

## Arguments for Active German Reform Policies

A vague negotiating framework is emerging for the revision debate. It will oscillate between fundamental political debate over the principal goals and tasks of the expanded Union at one extreme and concrete proposals for adapting the political and budgetary priorities to the new challenges at the other—but without these proposals being expressed in precisely calculated budgetary terms and without the fundamental debate manifesting itself in specific formulations for adapting European primary law.

In the best case that can be expected, new principles, targets, and structures will be discussed, agreed unanimously, and then given the necessary political weight by a decision of the European Council, so that the revision can then be implemented in the course of the actual 2011/12 funding negotiations. So at the end of the revision process there could be a decision of the European heads of state and government containing the most specific possible requests to the Commission and the ministerial councils and differentiated by policy field and specifying material and financial goals for reform of individual areas of policy. In the case of a successful conclusion to the revision process, the funding negotiations would have to follow without delay in order to 1. maintain the impetus for reform, 2. subsequently also to maintain the pressure of legitimization for revision of the European Financial constitution, and 3. thus to prevent any possible relativization of reform initiatives.

Germany has a fundamental strategic decision to take. Does the German government want use the revision process to further its own reform goals? And if so, which goals could those be and when and in what form should Germany position itself in order to participate in this revision process?

If the German government responds affirmatively to the first question it should join the reform debate at an early stage to guide the revision process and give it direction. But if the answer to the first question is no, the task of German policy will be to avoid premature positioning in the upcoming debates in order to “keep its powder dry” for the talks on the Financial Framework 2013–2020. At the same time any tie between the negotiating topics for the 2008/09 Financial

Framework and EU appointments must also be prevented for as long as possible.

The decision on this fundamental choice of course depends first on the just concluded Agenda 2007 negotiations. If the German government continues to regard the manner of the negotiations on the Financial Perspective as practicable and the dominant logic of net balances and “*juste retour*” as acceptable, and sees this as a format for negotiations on the EU budget and the Financial Framework that also promises success in the EU27, then it will be skeptical about any alteration of the status quo—which is always associated with a high degree of uncertainty. But conversely, if it concludes from the history and experience of the funding negotiations that the European budget system is in need of reform and the expanded EU’s ability to function smoothly and act decisively cannot be guaranteed in the longer term then it must use the revision clause to further its own reform agenda.

So the heart of the matter is more than just a purely budgetary or fiscal question, it is an important choice of integration course and a decision whether or not to strengthen supranational autonomy in the European multi-level system. This applies both to the European spending priorities that are to be defined in the course of the revision debate and to the question of an autonomous EU resource. It is impossible to ignore the crass contradiction involved in demanding a “European constitution” while at the same refusing to increase the autonomy and capacities of this then clearly deepened EU; all the more given that the volume of the EU budget is actually rather small in relation to the national budgets.

Both options—actively using the reform process for development and therefore stating material positions at an early stage or orientating the reform process on the status quo, aiming for limited pragmatic modifications, and therefore waiting before revealing ones own negotiating goals—contain tactical negotiating opportunities and risks. If, after the informal opening of the revision process through the publication of the Commission’s fourth cohesion report in spring 2007 and the European Parliament’s Lamassoure report, a sufficiently strong momentum for reform builds up, being late in defining interests and taking positions



could mean missing a chance to guide the process and an opportunity to define the goals of reform. Conversely, however, taking an early stance on controversial issues such as the introduction of a generalized correction mechanism on the revenue side or cofinancing of the CAP on the spending side could mean losing a negotiating edge that would certainly have been useful in the conflict between the UK and France.

Regardless of this fundamental political decision it is imperative for the political operationalization that the German government agrees internally on national political principles for the revision process. These principles could serve as a strategic and tactical navigation system to guide the German government productively through the revision process. It could also help to adapt the procedure if the scenario changes or changes occur in the political environment.

From the German perspective it could be advantageous that Germany was pushed almost automatically into the role of mediator between the two poles of the UK and France during the final phase of the last round of negotiations. The German government should build on this role in the revision debate. The goal of German policy should be to use the institutional interest of the EU institutions in expanding their political responsibilities and gaining additional funding instruments to its own ends. So if the cohesion states in southern Europe are very interested in receiving aid from the EU budget to resist the exceptional pressure of migration from North Africa, this aim could be tied to a shift in EU spending priorities from the field of classical cohesion policy to interior, justice, and migration policy. This would correspond to the interests of the Commission and the European Parliament, which precisely in this field of policy have identified an important new sphere of activity for the EU. In a similar way, with regard to the new member states in central and eastern Europe, the political goal of a visible (also financial) strengthening of European Neighborhood Policy toward the eastern European neighbors could be tied to reform of the CAP.

So the task of German policy on Europe should be to show potential ways in which funding negotiations can be diverted to new fields of policy despite a strong focus on national interests in some states. In these fields of policy the EU budget should then primarily be used to promote shared public goods that promise added value for the Union as a whole and for its member states. Emphasizing allocative funding at the expense of redistributive would also meet the British

demand for modernization of the EU budget and conversely create the basis of legitimacy for greater autonomy in EU funding that the French always call for.

## Abbreviations

GDP	Gross domestic product
GNI	Gross national income
GNP	Gross national product
ERDF	European Regional Development Fund
EC	European Community
EP	European Parliament
CAP	Common Agricultural Policy
IIA	Interinstitutional agreement
PPS	Purchasing power standards
WTO	World Trade Organization