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**Research Report**

## The future of the European community's resources and the implications for Romania's contribution to the EU budget

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# **The future of the European community's resources and the implications for Romania's contribution to the EU budget**



**EUROPEAN INSTITUTE OF ROMANIA**  
*SPOS Project 2009 – Strategy and Policy Studies*

**Study no. 2**

**THE FUTURE OF THE EUROPEAN COMMUNITY'S  
RESOURCES AND THE IMPLICATIONS FOR  
ROMANIA'S CONTRIBUTION TO THE EU BUDGET**

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**Bucharest**  
**December 2009**

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## Foreword

The research- development program destined for the Strategy and Policy Studies – SPOS, launched by the European Institute of Romania in 2006 in order to support Romania in exerting its attributions as EU member state, has continued in 2009 through a new series of studies.

The topics approached have answered different requirements, of great interest from the perspective of the evolution of the Romanian economy and society, representing the result of both a consultation process as well as of national and European programmatic documents, and institutional requests, as the representatives of the central administration present at the European affairs coordination meetings perceive them.

The studies provide founding elements for the main directions of action in order to bring to fulfilment some measures adopted at the European level (*Public finances: Introduction of a medium-term budgetary framework; The Future of the European Community's Resources and the Implications for Romania's Contribution to the EU Budget and The Impact of the Implementation of the Energy-climate Change Package on the Romanian Economy*), as well as perspectives of Romanian policies aiming to promote national reform measures in a European context (*Flexicurity and social dialogue in Romania – Perspectives on the implementation of flexicurity principles in Romanian undertakings and Improving vocational competencies among graduates and youths: A chance for the future*).

The current series of studies has benefited from contributions of a research team made up of:

- Mr. Napoleon POP is director of the Financial and Monetary Research Institute “Victor Slăvescu” and member of the Board of Directors of the National Bank of Romania;
- Mr. Nicolae DONE is consultant with KPMG and has an extensive experience on fiscal issues, including as manager with the Public Finance Ministry of Romania;

- Mr. Mihai DIMITRIU is deputy director of the Financial and Monetary Research Institute “Victor Slăvescu” and author of a variety of publications on fiscal and monetary policy.

Throughout the elaboration of the above mentioned study, the research team has enjoyed the active contribution of Mr. Iulian Oneasca, as Project coordinator on behalf of the European Institute of Romania, as well as the support of a working group, consisting in representatives of the main central administration institutions with attributions in the field.

**Gabriela Dragan**

Director General of the European Institute of Romania

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# **THE FUTURE OF THE EUROPEAN COMMUNITY'S RESOURCES AND THE IMPLICATIONS FOR ROMANIA'S CONTRIBUTION TO THE EU BUDGET**

*“The budget of the European Union has always adapted to change. Now this change is occurring at great speed.”*

*Jose Manuel Barroso,  
President of the European Commission,  
speaking at the opening of the conference  
“Reforming the budget, changing Europe”,  
November 12 2008.*

## **Acknowledgements**

This study on reform of the European Union budget (EUB) was commissioned independently by the Romanian European Institute. It is not a follow-up to previous studies, although the authors have used previous research in their work. It does not form part of a series on this issue, which is viewed with great interest throughout the EU. The large number of studies on this subject indicates how important the issue of the Community budget has become. The wide ranging debate on this issue gives a unique opportunity to involve member states, especially those new to the club, in perfecting the budget mechanism, as there are numerous criteria that can be used to bring together the interests of the large group of countries which are members of the European Union today.

According to the theme and terms of reference, the authors focused on an approach that would respond to the necessities of the present stage of coordination of national efforts towards a common viewpoint, which would support with a set of ideas Romania's position during the process of reform of the EUB. As such, the authors have not aimed to write a comprehensive piece of research which would give definitive conclusions on the issue. Rather, the aim has been to analyse an ongoing process, for which only those reference points that, according to the authors, are significant for the

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timing of this study with respect to Romania's activity and contribution to reform of the EUB were identified..

As there is no obligation to offer numbers relating to reform of the EUB and without knowledge of any study related to the present quantitative impact on Romania's contribution of any restructuring of the EUB's own resources, we believe at this stage that we can focus on the implications for Romania's contribution of the future for the Community's own budget resources in a broader sense of their significance and ordered by their quality and quantity. We do not believe that we can directly and immediately offer a quantitative simulation, as long as there is no prospect of a consensus over the future of the EUB budget's own resources, which could in turn offer more rigor to the impact analysis, and even pros and cons.

From the very beginning we should specify that Romania's national interest as a member state of the EU must be linked to its freedoms and responsibilities that derive from its rights and obligations in accordance with both the EU Treaties and Romania's Accession Treaty, as well as with national legislation. Also, one cannot ignore the fact that some of the five scenarios for the reform of the EUB, drawn up, based on an extensive analysis of the questionnaires, have large-scale institutional and legal implications, which can exceed the strictly technical character of a quantitative simulation.

This approach of the national interest in the accession process to the EU is a perfect match for the voluntary application of the *acquis communautaire*, with a note that since its accession, Romania has been a contributor to the evolution of the *acquis*, a new position of promoting the national interest from within the club and not as an outsider.

We have avoided using "can contribute" to the development and/or improvement process of the *acquis communautaire* as the political option to join the Union was based on and justified by finding a formula for direct involvement of Romania in the European construction process following the EU model, the only sure way to promote the national interest in Europe and beyond.

The Community's budget- which promotes EU policies - to which Romania contributes and benefits from as a member state - is one of the main instruments to promote the national interest. The Romanian authorities consequently need to play a full role in the decision making process over how the EUB is funded and how its resources are used.

The authors believe that it is their responsibility too to contribute to this decision making process. They have consequently set out some

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suggestions for the Romanian position on the EUB reform process, which is so critical for the EU's future financial planning.

From a technical point of view, and remembering that we are not discussing figures at this stage, the orientation of the study gives priority to quality and acceptance of the future own resources of the Community, as resulting from processing the information deriving from public consultations, without leaving out the probable quantitative expansion in the structure of the EUB's financial resources.

As such, we believe that starting from a position that the Romanian authorities have up to now taken a conservative approach, the implications of a future diversification of financial resources (the so-called authentic-Community Resources) as well as the possible disappearance of some of the traditional functions of the EUB, makes it necessary to assess Romania's institutional capacity to implement reforms to the EUB, the acceptance of change by the business community and also the need for transparency, simplicity and breadth in the use of the EUB.

In our opinion, as quantitative impact, at this stage we can suggest that, using the current resource composition of Romania's contribution to the EUB's income, we could focus the simulation on two main directions: evaluation of the impact resulting from filling in the national questionnaire and the evaluation of the impact resulting from considering the five scenarios or in considering in another form at a European Commission level, the multitude of opinions collected through the national questionnaires.

## Abstract

Studying the implications of the future resources of the EUB over Romania's contribution becomes more and more important as Romania integrates into the economic and political elements of the EU. It will become even more significant when the country eventually joins Economic and Monetary Union (EMU).

The timing of the study, correlated with the community's events focused on reforming the EUB's resources, with well-set deadlines, underlines the importance and necessity of adopting on the move a broader institutional step for the Community –budgetary reform – initiated well before Romania's accession and now undergoing development. This importance is redoubled by the necessity of involving Romania, even by coercion, from the very beginning, in the technical and political mechanism that creates the multiannual financial framework for the EU's institutional function, especially in the area of implementing its policies.

Perfecting the mechanism referred to has failed, in every stage of the final negotiation process (we recall December 2005), to proportionally diminish political confrontation, which is otherwise a normal part of political life, between heads of state and government, which precedes the vote for a new budget. The size of the budget, its evolution, the gross contributions correlated with the gross national income (GNI) of member states, the net contributions reflecting the benefits of redistribution of incomes (either by expense size, or by expenses assigned to objectives of community policy), applying correction and compensation mechanisms, the difference between allocation for engagements and payment etc, all turn into battlefields for solid arguments of principle between each member state in the individual cost-benefit equation of the Community's budget.

As usual, this positioning necessitates a call to political instruments and political support, thus promoting the national interest, exposing conflicts and building compromise.

Starting from the study's objective, to offer necessary elements for the inter-institutional working group for the development of Romania's position on reforming the EU budget (GII), an objective linked to the timetable and qualitative stage reached by the reform proposals at the Union level, and for which we expressed the necessity of introducing and involving Romania, we have set out to structure the work in such a way as

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to prioritise the support elements to identifying implications and ways of action.

Obviously, these elements will take into account those reference points seen as restrictions or national and contractual constraints, voluntarily assumed, resulting from the accession treaty, which defines a certain framework for free initiative, in an area which is not only highly specialized, but extremely sensitive when it comes to funds representing national contributions to the Community's budget.

From this perspective, and with the limitations already presented in the acknowledgement, the study is structured into three analytical parts. The first part refers to the predicted form of the Community budget reform, through the conceptual and political approach that is currently on the agenda and the stage for generalization of the scenario's conclusions created on the basis of synthesis of the options already expressed. The second part refers to the Community budget analyzed through politics and management, both appreciated for their technical value alone.

The first two parts provide a viable construction to anchor the elements needed to formulate a national position in the reform process of the Community budget, which does not exclude modifications of mechanisms and legislation, setting the scene for a professional debate which should give coherence and consistency to the political discourse on the national position.

The third part is dedicated to analyzing and identifying the implications of the Community budget's future resources, based on the five scenarios already specified in the final report of the study carried out by the London School of Economics and Political Science, made to order for the European Commission, General Department for the Budget, finalized on April 29, 2008. We suggest that Romania's contribution to the reform of the EUB should be included in all five scenarios – in one form or another. The document used by researchers summarizes national opinions regarding: (i) the evaluation of the present functionality of the current EUB resources system; (ii) the opinions regarding the reform of these resources in the medium and long term.

We believe that these opinions did not exclude the role of the community's budget (administrative-functional and in the process for the implementation of the objectives for common cohesion and agricultural politics, energy strategy and climate change, immigration management, demographic changes, Lisbon Strategy) and the financing of the budget (size, resources, correction mechanisms, budget resources as perceived by citizens, weighting the resources against common policies).

Following the practical purpose of supplying the necessary elements for GII, we should insist from the very start on the significance of the exercise for the reform of the Community's budget, as shown by the public consultation synthesis. Thus, reform of the EU budget is the only option to adapt it to a fast changing world, and almost all contributors voted in favor of reform.

The objectives of the common policies are in continuous need of financial resources, which means that the reform of the EU budget is open to any new ideas that could focus expenses on the future challenges and not on the frustrations of the past. This means to accept the modification of the center of gravity of the budget's execution – already ongoing – towards the new priorities signaled by member states and which comprise competitiveness, environment and energy. The new Union – of 27 members – which will determine the configuration of the new multiannual financial framework, demands performance criteria for the functioning of the present system of budget resources which must be more equal and transparent, eliminating the correction mechanisms that conceal negotiations no longer justified within the Union

The dynamic of the times requires the revision of the relationship between stability and operational flexibility. There must now be greater stability in the execution of the budget, and the rigidity of the expenses chapters must be overcome, to reduce the differences between committed and payment allocations.

The authors express their view that the implications of modifying the EUB resources, defining a new reform, regardless of its scale, are multiple, cannot be reduced to the simple quantitative impact, and their importance must be prioritized in accordance with the national institutional situation, with the mechanisms and functionality characteristic of the current state of Romania's integration, all as a single process. From this point of view, the EUB reform should be seen as an opportunity to make these evaluations and recommendations for change, which would eventually help ease difficulties caused by the quantitative impact of Romania's contribution to the resources of a reformed EUB.

# SYNTHESIS

## **1. Reforming the EU budget, an ongoing process**

Starting 2006, according to the inter-institutional agreement, the EU launched an important process of reforming the community budget. The process was determined not only by the general interest to improve any instrument or work mechanism, the EUB having a fundamental role in translating into reality the objectives of the common policies, but by the internal and external developments that have presented the Union with new challenges: geographical expansion and broadening the areas of integration, globalization, and – more recently – the economic and financial crisis.

The project to significantly re-evaluate the functioning of the Community budget envisages not only of the involvement of the Union institutions, but also the support of wide-ranging public consultation, which shows the real interest for viable, acceptable results, which can be assimilated to improving the concept and operations of the EUB.

We should note, at the same time, the generous timetable designed for this process, correlated with the possible assimilation of new ideas for the reform of the budget within the future multiannual financial framework of the EU, deemed to begin in 2014, thus proving the strategic vision of reform, which is expected to result in the qualitative restructuring of the EUB which will increase its efficiency and adaptability to fast changes.

Encouraging initiatives, ideas and contributions at a member state level, and at that of civil and academic society were based, among other criteria, on giving up some taboos from the very beginning, especially by removing the constraint of numbers, just to stimulate and concentrate the creative effort on the instrument represented by the budget in management of Community policies and not on the amounts of the expenses, an area of negotiations that has always proven difficult, especially while modifying the multiannual financial framework.

It is extremely important that reform of the EUB is desired politically, is in an advanced technical stage on the board, has the motivation of the need for a re-evaluation of the efficiency of the current financing system and it – the EUB reform – is registered in a program with a good chance that the measures agreed upon at the end will be introduced at the end of the present multiannual financial framework.

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According to the Lisbon treaty, it is possible that the incorporation of some reform elements of the EUB could occur sooner, depending on the pressure either from external challenges affecting the EU, or from internal needs of the Union, led by the desires of member states.

The structure and mechanism of today's EUB have a history which has developed from the simple to the complex, enforcing not only the idea of a continuous development process, but the necessity to adapt to the three development dimensions of the EU: geographical expansion, enlargement of managed areas, as well as growing importance for integration issues.

From a purely administrative budget to financing priority policies, from the prevalence of agriculture in the budget – with the Common Agricultural Policy as its basis – to a budget that would respond to the needs of solidarity and cohesion, with a growing focus on economic growth and work force employment, all these steps show a continuous process of efforts dedicated to a budget which keeps pace with changes within and outside the EU.

A desideratum for a budget that will respond to competitive economic growth and to effective employment policies has had a growing significance from an expenses point of view, since the last financial downturn and its impact on the real economy.

The initial point of the EUB reform is the finalization of the multiannual financial framework (MFF) 2007-2013 (December 2005, with extension to mid 2006), when the Council of the European Union, at a level of heads of state and government, invited the European Commission to evaluate under several issues the incomes and expenses of the budget. The results of this evaluation were planned to be published in 2008-2009.

The public consultation was initiated by the European Commission, which invited all interested parties, at a local, regional and national level, expecting the contributions to help the Commission to develop a White Book on EUB reform. The Book was due to be made available for debate in all member state between 2009 and 2010.

Compared with the timetable of intended actions and convergence with the EUB, Romania is in a position of “*faits accomplis*”, characterized by its ex abrupto confrontation with its strong traditions and heritage reflecting the dynamic balance of forces within the Union, since before its geographical expansion. Once new countries join the EU, new competition is born, including not only the expectations and national objectives of the new member states, but the challenges set out by the EU's most recent strategies as well, which wish to be comprehensive and objective – especially the Lisbon Strategy, and the institutional transformation set out by the Lisbon Treaty.



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The EUB, considered as an important instrument that the EU uses to attain its political objectives, is, at the same time, quantitatively large, in terms of its absolute value (over 100 billion euros), but also small when related to the cumulated public expenses of the member states (approx 2.5%) or to the total EU GDP (just over 1%).

### **2. EUB reform – a focus of political confrontation**

Since 1980, the budget of the Community has been conceived as successive MFFs. Although the value of the EUB has grown over time in real terms, their proportion of Gross National Income (GNI) of member states has decreased, despite the geographic expansion of the Union and of the new common political objectives assumed (X). This discrepancy between the two aforementioned indicators did not make the periodic construction process of the budget immune from political confrontation, which could sometimes lead to crisis. This proves the high stakes both for the European Commission and for member states when the multiannual EUBs are decided..

EUB reform should prepare the ground for a new political consensus regarding the orientation of expenses included in the EUB, with an impact on a possible restructuring of the financial resources needed for execution, so that it could respond at least to the challenges expected over the next ten years. Consequently, new episodes of political confrontation can be expected.

The substance of possible political confrontation is given by the political agenda of the European Union, obviously undergoing a profound modernization process itself. Globalization has attracted new challenges, and issues such as climate change, migration and energy are now at the core of the European debate. Following the crisis, stimulating innovation, as well as developing aptitudes and an attractive business environment are more than ever at the heart of the strategy for economic growth and encouraging employment in Europe. At the same time, EU expansion has raised expectations of living standards from new member states, which has strengthened a positive perception and support for the solidarity and cohesion policies promoted by the EU.

We should underline that reform of the EUB at this time is not a mere administrative or accounting exercise, as it focuses on concepts while being free of negotiating numbers. But the reform draws attention to the political nature of the approach to EUB reform, starting right from apparently technical issues of possible future structures for the EUB

incomes and expenses, such as: the ability to adapt to the change, balance between stability and flexibility in the MFF, added value of the EUB etc.

Technically, this political support can have as its effect the modification of Romania's financial contribution structure to the EUB as assumed through the accession treaty. Such a situation creates a need for new debates at a national level, focused on the options for a quantitative impact of the EUB reform on Romania's contribution, options that derive from the choice of a scenario which hypothetically foresees optimal orientations for the Community's budget reform.

### **3. The role of the EUB reform, implications for Romania's actions**

The EU organized a conference with the theme *Reforming the budget, changing Europe*, from November 12, 2008, based on the document developed by the General Secretary and GD Budget of the European Commission, entitled *Report for consultation, the reform of the budget for a changing Europe: summary of the contributions* (dated November 3, 2008). What catches our attention is the fact that the objectives package emphasises the need to develop a strategic vision to maximize the added value that can be generated by the efficient execution of the budget.

This strategic vision is conditional on its association with the fundamental principles that guide European integration, as a solid structure, dedicated to the efficient execution of the Community's budget:

- (i) focusing the budget on the policies that have the best response to priority challenges that are faced by the EU.
- (ii) Fully aligning the subsidiarity and proportionality mechanisms.
- (iii) An ongoing optimization of efficiency, prudence and responsibility during budget execution.

The same principles are also objectives of the EUB reform, the contributions to the vision being expected to assist during the selection of the new measures that can be better and more easily translated into the EU values, given that Europe is changing because of new challenges.

The analysis of documents dedicated to EUB reform draws attention to an essential fact: that implications of the modifications of EUB resources, defining a reform, regardless of its depth, are multiple, and their importance must be prioritized in accordance with the national institutional situation, including mechanisms and their functionality, characteristic for the current stage of Romania's integration within the EU, all seen as an ongoing process.

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From this point of view, EUB reform should be seen as an opportunity to evaluate and recommend corrections that should help reduce the negative effects of the quantitative impact on Romania's contribution to the reformed resources of the EUB.

Although the task of giving global dimensions to the new multiannual financial framework (MFF) will belong to the new Commission appointed following the re-election of Jose Manuel Barroso, the structure and orientation of the future priorities of the Union regarding expenses, though outlined by the Lisbon Strategy, should provoke, even at this stage, a new baseline political debate, at least about the way countries are positioned and the expected benefits which will follow as a result of the added value which the new budget will bring.

It is possible to accept that this positioning has major elements relating to the probable modification tendencies, already known, but the particular case of Romania is the fact that it is less likely to make on its own territory consistent evaluations - for those changes where no functional continuity and concrete results exist - of a category of expenses that support common policies from which benefits are still expected.

Returning to the open opportunity to reform the EUB, identifying multiple implications of possible modifications in the financial resources of the EUB over the national contribution to the budget, shows the need to formulate a new national strategy for economic and social development in the medium and long-term, with deadlines which fit in with the timetable for MFFs. This strategy must be aligned to the new challenges in Europe and in the world caused by the present economic and financial crisis. Large scale support from the EU budget can be of considerable benefit in supporting national programmes to tackle these issues.

The objectives of the common policies are in continuous need of financial resources, which means that the reform of the community budget is open to any new ideas that focus the expenses on meeting future challenges and avoiding the pitfalls of the past. This means accepting modification of the focus of the budget- an ongoing process - to support the new priorities already pointed out by member states and which relate to competitiveness, environment, and energy.

The EU - as 27 members - will surely encounter difficulties in configuring the new MFF, as opinions expressed on the ways to reform the EUB underline the need to improve the performance criteria of the functioning of the EUB's current own resources (OR) system, as well as those of balance and transparency, eliminating the current correction system

that, according to several opinions, is no longer justified. The dynamism of challenges calls for the review of the balance between stability and a greater operational flexibility in the budget execution, so that the rigidity of the expenses chapters can be surpassed, and this should in turn reduce the difference between committed and due-payment allocations.

In addition to assuming a national contribution to solving the challenges that the Union faces, already mentioned – an increase in European competitiveness, climate change, access to primary resources and energy, alternative energy sources, energy efficiency and security etc – we have to emphasize the possibility of disproportionate political support at a community level at the time when EUB expenses are allocated to similar projects in different member states. This involves a strong national ability to intervene in the determination of EUB expenses, including by association with other member states in large-scale projects that directly affect Romania.

Underlining the benefits of not having to deal with numbers at this stage, we notice that the opinions expressed in the questionnaires focus on the quality and degree of acceptance of the future OR of the community, which includes the so called authentic own resources of the Community (ACOR). As such, the implications of new financial resources can be classified in evaluations of institutional and economic sustainability, and as a mechanism of Romania's contribution to the reformed EUB, at the same time simulating quantitative evaluations, without disregarding criteria of transparency, simplification, equilibrium, efficiency etc criteria, whose evaluation is included in the national responses to the public consultation questionnaire.

The interest shown by the European Commission for the EUB, seen as a great opportunity, should be noted in the sense that the technical or methodology nature of the impact of reform of the EUB on Romania's contribution to the community budget is expected to generate internal political decisions regarding at least three important issues:

- (i) presenting a case in Brussels in favor of those variations of the EUB reform which specifically address Romania's opinions and interests
- (ii) preserving Romania's position as a net beneficiary
- (iii) rapid assimilation of the principles of the Community budget into the mechanism for developing the national budget, from the point of view of a better compatibility on objectives and of a continuity of Romania's financial contribution to the EUB.

The overview of the community's budget reform should be perceived in several dimensions, which is, perhaps, the main cause of

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possible difficulties that will accumulate while nearing the end of the current reforming cycle for the EUB, which is the precursor to the actual negotiations between member states for the future multiannual financial framework (MFF).

The method for setting out the entire process for the possible reform of the EUB is also an opportunity to identify some of the aspects of positioning the national interest. These relate to the principles of freedom of approach, reform points, constraints imposed by treaties, as well as promoting the national interest through reform of the community budget.

The justification at a national level for modifying the financial resources that constitute Romania's contribution to the reformed EUB – if this reform will be concluded– involves a greater transparency of how the funds allocated through the EUB are being used or of the probable benefits that arise from using them, preferably at the level of the citizen.

We should not omit the fact that in opinion polls regarding Romanian citizens' opinions on EU accession, before the actual event, enthusiasm for knowledge and benefits prevailed over costs. This situation changed radically when the *acquis communautaire* was applied to normative and institutional functioning, open labor markets and, especially when politicians became involved in the legislative organisms of the EU. Consequently, greater understanding of the process of EUB reform has become a priority.

### **4. Strategy for the annual policy for 2010**

At the beginning of a year, the European Commission communicates to the European Parliament, the Council, the European Economic and Social Committee and to the Regions' Committee the strategy of annual policies for the year. The purpose of the document is to establish the working agenda and launch the European inter-institutional dialogue regarding the priorities for the year ahead. The process is the first step on the road to consensus on the main policies which will form the basis of the future MFF under the Commission's mandate.

Proposals for the priority policies of the EU, as well as those regarding the general framework of the human and financial resources as established by the annual policy strategy for 2010 bring to the attention of Romania commitments already assumed in the two years since accession. As such, Romania's positioning on EUB reform should take into account the ongoing priority policies which should have financial support.

In these conditions, the present level of the resources and the efficiency with which they are spent becomes a clue as to the future proposals for preservation, increase or diversification of the budgetary resources for the future MFF.

Regarding the weaknesses and vulnerabilities of the current MFF, which have been made more apparent by the downturn, 2010 should see the corrections already requested by member states being made. These should be found in the concept of the future multiannual financial framework, and it is to be hoped that their effects will be enhanced through the benefits that the EUB reform will bring.

The priorities are, in the following order:

(i) Economic and social rectification, a priority policy which ensures an effective follow-up of the European Plan for Economic Rectification

(ii) Climate change, a priority policy deriving from the EU's commitments, according to the new international agreement on climate change, a policy which will pave the way for major investments in the long term and with effects for the evolution of technology.

(iii) Citizen above all, a priority policy in the first year of implementation in 2010, according to the Stockholm Program for liberty, security and justice.

(iv) Europe – a global partner, a priority policy which has two essential elements; meeting the challenges of globalization in various areas and the involvement of the EU in helping poor countries to recover from the present crisis.

(v) A better framework for regulation and transparency, a priority policy that aims to simplify the Community's legislation and bureaucracy, without affecting its quality.

All these priorities apply pressure and have institutional and legislative impacts which cannot exclude the political area, and addressing the issue with multiple, open consultations is more important now than ever, since EUB reform affects the national public finances, considered an area of great social and economic sensitivity.

## **5. The main conclusions of the European Commission regarding the results of public consultations**

At the end of 2008, the Commissioner for financial programming and budget, Dr. Dalia Grybauskaitė, presented the main conclusions generated by the public consultations on EUB reform. The consultations resulted in member states sending their official contributions based on

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questionnaires, over 2000 persons in 20 member states debating the issues concerning EUB reform, with approximately 300 specific contributions referring to a various aspects related to the reform.

The public consultations have generated several relatively powerful common messages:

(i) The EUB is the main instrument through which the Union can handle changes at European level;

(ii) The rapid modernization of the EUB is the chance for the Union to find solutions to new risks and challenges;

(iii) Added value related to the implementation of the EUB is the main parameter for the efficiency of the community expenses at a European level;

(iv) It is preferable to reject the "juste retour" concept when the orientation of the EUB expenses is on the table, as it becomes an obstacle for any debate reaching a meaningful conclusion;

(v) The challenges that the EU needs to respond to – which should be reflected both conceptually and operationally in the EUB's approach – climate change, the need to increase the EU's competitiveness in a globalized economy, ensuring energy supply security, inequalities between countries and regions, an ageing population, as well as external factors that generate pressure or constitute threats for the EU.

The overall theme of these messages and of the order of the challenges from the point of view of their importance at the European Commission level – given the concerns for the restructuring of the EUB financial resources as resulting from the Consultation report and from the Final Report of the London School of Economics and Political Science (April 29, 2008) – emphasizes the following points with respect to the future use of EUB funds:

- *Areas on which spending should increase:* to ensure competitiveness, based on improving research and innovation; for environmental protection and reducing the effects of climate change; supporting the more direct funds; for energy, including security in supply sources targeting projects for alternative inter-connection.

- *Areas on which spending should decrease:* spending on agriculture, conditioned by its alignment to common objectives, at the same time reducing allocations as direct assistance.

- *Areas on which spending should stay the same:* continuing support for expenses that put the cohesion principle into operation, with a note that there is a need to modify the policies regarding application:

focusing funds for the less developed states or regions of the Union and ensuring a faster economic convergence of member states.

The new orientation of EUB expenses, starting from restructuring priorities for the common policy objectives, will therefore comprise the current resources, as well as new financing possibilities in the future for the community budget. The greatest support is for the idea that the EUB's financial resources should reflect the new objectives of the EU policies. But, admitting the principle that common policies need adequate funding does not necessarily mean simplistic acceptance of a significant quantitative increase of the EUB's income, either in absolute terms, or as a percentage of the EU's total GDP.

The idea that the financing should relate to the scale of the policies the Union is committed to through the consensus of member states, implies both preservation and restructuring of various areas of the EUB: continuing the support of the traditional own resources (TOR) of the EUB, cataloging contributions determined on the basis of GNI as the safest, gradually eliminating contributions determined on added value, as well as accepting alternative resources following the examination of their applicability in accordance with the evolution of the EU's policy priorities and their legislative and institutional impact.

The mechanism for correction/compensation, which has been considered in correlation with the reform of the EUB's financial resources, must be applied uniformly, eliminating privileges earned by some member states, including under the influence of national political pressures applied under circumstances that have now altered.

The summary of the public consultation conclusions for the financing resources of the EUB does not exclude the relevance of the opinions expressed in relation to the EUB's efficiency. For this issue, and encouraged by the need to eliminate the "juste retour" concept, we should mention the diversity of means through which the budget can be made more efficient. These can be focused in four directions:

(i) increased transparency, meaning easy public access to information regarding the creation and execution of the EUB

(ii) a simplified structure, which is equivalent to integrating all expenses in the budget

(iii) strengthening the responsibility of member states, which should end up managing 80% of the resources redistributed through the EUB

(iv) a greater flexibility in the implementation of the budget, to give the EUB the chance to react more quickly, through spending, to the challenges of a changing Europe.



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### **6. Scenarios for the reform of the EUB**

The scenarios to reform the EUB's own resources, as formulated in the Final Report of the European Commission, created inclusively on the basis of the Report presented by the London School of Economics and Political Science, suggest several possible implications of reform depending on the following:

- (i) instruments for the substantiation of own resources;
- (ii) the sufficiency or insufficiency of the EUB's incomes;
- (iii) the assignation of the burden of contribution to the EUB between member states;
- (iv) correction/compensation mechanisms;
- (v) institutional issues;
- (vi) stability of the Union Treaty.

Regardless of what point of view we may choose to look at these issues – as areas, principles, criteria etc – being negotiation subjects for EU member states, the first connotation of the implications of own resources reform is of a political nature as well, as it targets political action to accept, reject or support a scenario or a combination of variants.

The five scenarios, which are intended to be considered in succession and which have been developed on the basis of solutions and their sustainability over time, are listed in the following order; Minimum Reform 2013, Own Community Resources 2013, Minimum Reform 2020, Own Community Resources 2020, Taxation by representation.

Scenario 1 - Minimum Reform 2013 – practically, this brings no essential modifications to the current EUB income resources' system, based on two resources – Traditional Own Resources (TOR) and Resources based on the GNI – excepting the consensus that the resource based on VAT becomes the second most important, following that based on the GNI and with a tendency towards abolition of that based on VAT.

Scenario 2 - Own Community Resources 2013 – this would involve member states deciding on two issues over the next medium-term financial outlook: (i) to begin ensuring authentic Community own resources (ACOR) for the income of the EUB, without excluding TOR from the national contributions; (ii) maintaining unmodified all the construction elements of the EUB.

The two notes regarding member state decisions on scenario 2 include the following additions as quantitative interpretation: (i) TOR will have a lower proportion; (ii) non-tax instruments on income, mainly in flight duties an/or trade of greenhouse emissions certificates, should reach a

proportion of 25% of the total resources of income of the EUB; (iii) the GNI-based resources should progressively increase.

Scenario 3 – Minimum reform 2020 – considers the long term but, under the apparent compatibility or similarity with the resources of scenario 1, it postulates progress on the expenditure part of the EUB, meaning that the territorial principle of the expenditure packages is no longer a priority, which amends the approach of “juste retour”, losing its role as an essential principle. The modifications would put first the principle of ability or capacity to pay as an argument for increasing the EUB’s revenues.

The argument for the effort for progressive payments, within the area of national contributions, is inspired from the typical attribute of progressivity of a fiscal system, which legitimises the principle of contribution equalization. The chance for a green light for scenario 3 in this form is given by the corresponding increase in the proportion of expenses for public goods at an EU level, in contrast with decreasing territorial redistributive spending.

Scenario 4 – Community Own resources 2020 – is based on the need to align the EUB issues to the current state of political integration, noting that the history of European integration has been governed rather by changes to increase the number of members or changes to areas that are subject to integration – incremental changes – than by significant institutional leaps - big institutional leaps. The scenario proposes an evolution towards an authentic budget for the EU, which reflects the type of system for integration represented by the EU itself, as it is. As such, we propose a combination between the contribution of member states with taxes and non-taxes directly taken-over from an EU level, assimilating a powerful Community character – common European character – such as tendering of environment licenses or obtaining incomes from the European Central Bank’s banknote issuance.

Scenario 5 – Taxation by representation – looks beyond 2020, to eliminate all obstacles in the path of an authentic community budget, which suggests a scenario on a longer term than originally defined in accordance with the period of reference of the current EUB reform. From this point of view, scenario 5 involves changes in the Treaty of institutional reforms, similar to those processed during the Lisbon treaty, even with respect to the EUB. Relating to the latter, we should mention that the perception of the authors is that scenario 5 implies new possible difficulties for some procedures regarding the construction and putting into operation of the community budget, but solving these relies on implementing in stages the EUB reforms suggested by the prior scenarios.

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The advocates of this scenario state that it could ensure an authentic budget at an EU level, as an instrument for the implementation of political and common goals, free from redistribution practices, and thus having the advantage of a real allocation of all partners in "juste retour". We should emphasize the fundamental principles of this scenario, which should eliminate the opposition of member states to the necessities of an increase in the EUB's income.

Thus, the prime source of EUB incomes should rely on ACOR, alone or combined, with the tax or non-tax resources at a EU level, and should ensure a sufficient level for the financing of a large part of the EUB's spending. The equilibrium rules of the budget should be relaxed or, in the best case scenario, the residual source of balance should be kept, based on the GNI with regressive evolution.

The principle of progressivity of the residual resource based on the GNI contribution should be considered in the equitable redistribution scheme between the EU states of the financial pressure between national contributions, which means, from the point of view of the qualitative impact of the scenario – with the acceptance of a mandatory improvement of the EUB with a significant increase of public goods and European common policies parallel with the added value – that member states should also accept an increase of the national contributions based on the GNI. This increase, desirable from the point of view of this scenario, could reach 2.0-2.5% of the GNI, recognized as extremely ambitious by the authors of the study.

### **7. Implications for Romania and its financial contribution**

EUB reform, according to the questionnaire filled in by the administration of member states regarding the Union's own resources, appears as only a technical application, and limiting discussion to this simplistic understanding is not only deceitful, but harmful as well. Although Romania is a member state of the EU, it remains an emerging market and is still undergoing transition from the point of view of consolidation and maturity of democracy and the market economy, values for which political action remains a priority. From this perspective, any action which is apparently technical still needs strong political support.

Romania, with its short experience as a member state of the EU, was unable to participate when the last multilateral financial framework was developed. This is the main argument to observe the multiple implications of the EUB reform from relatively coherent scenarios. The mere observation

of the answers provided by Romania for the questionnaire supports the argument for the priority of political involvement by the very fact that the qualitative evaluation of the performance criteria of the current own resources system, as grouped in the questionnaire developed for member states' administrations, is focused on the same medium term, from which the extremes which could lead to serious disagreement have been eliminated.

As such, the answers to the questionnaire place Romania among the many countries that are not fully content with the current budget structure, according to the expression used by the Commission in the "Consultation report". Moreover, the multitude of negative answers or viewpoints that corrections, compensation and equalization mechanisms have been incorrect show an opposition by Romania to previous decisions by the EU regarding the EUB's methods of operation, decisions which were taken following significant political involvement, while reform in these areas also requires political action.

Though the authors of the five scenarios ensured that they follow a correct design of coherent paths to reform the financial resources of the EUB through the proposed changes, the status-quo principle is recorded in scenarios 1 and 3. Scenarios 2 and 4, and – eventually – scenario 5 are based on reducing the proportion of national contributions and their replacement with ACOR.

All scenarios should point to an ideal solution for a mix of different resources for income which will provide a smooth impact of redistribution, without convulsions or contrasts, over the period of switching to taxes or non-taxes at an EU level, correlated with the introduction of an automated equalization mechanism on the revenues side of the EUB.

The five scenarios of EUB reform draw attention to the possible complications of some changes, even if these are gradual, generated by one option or another, changes that should be functional at a EU level through the present or reconfigured mechanisms at a national level. The invitation to new authentic resources of the EUB raises the issue of reducing the effects of existing economic disparities, traditional and economic, between the member states, reform of the EUB having the ability to provide a solution to this problem.

At the same time, we cannot overlook the opinion regarding a possible orientation of the reform of the EUB's own resources system in the medium term, according to which the options tend to preserve principles regarding the size of the EUB, fiscal sovereignty and neutrality, while, in the long run, we should expect a solution to completely eliminate correction

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– equalization mechanisms and to underline a closer connection between the spending and revenues of the EUB, given a context of maintaining the present good performance of some criteria and improvement of the weak.

Comparing these national basic views with the summary of opinions extracted by the EC from the five scenarios regarding the reform of own resources leads to a first conclusion that Romania supports – up to a point – to the need for change, possibly in the more distant future.

Limited appeal for introducing new resources as well the conclusion emphasising the strong preference for simplification and reform until the elimination of the correction – equalization mechanisms, are in accordance with Romania's opinion. We should emphasize that, as a conclusion of the study, the predominance of a conservative approach in the Own Resources (OR) area, generally, and in the Traditional Own Resources (TOR) area, especially, coupled with the strength of demands to remove correction – equalization mechanisms (as soon as possible), is contradictory – to some level – to the high expectations regarding the need for a higher relevancy of the principle of added value of the EUB's execution, where the Commission sees a significant degree of convergence towards the main “political challenges”, as effects of globalization. These challenges test the ability of member states to model and manage the consequences of globalization without the instrument represented by the EUB.

Scenario 4, which involves the greatest degree of change, would require the modification of the EU Treaty, which in the present conditions raises political problems that should be avoided, according to the authors. It is possible that a period of 11 years, until a possible implementation of scenario 4 would allow member states to reach consensus on their viewpoints, if we take into consideration that, in the past 20 years, the timeline to modify the European Treaty has been an average of 6 years.

Another political implication of scenario 4, at an EU level and derived from the need to modify the EU Treaty, would be the right to be granted to the European Parliament to validate laws on taxes with an authentic Community character. This right involves a difficult debate on fiscal sovereignty, since the principle of co-decision making regarding the power to set taxes could also remain at the level of the European Council.

Faced with these complications, creators of scenario 4 have accepted that a less ambitious version of it might need to be introduced, to avoid the need to modify the Treaty. This option would involve limiting the scenario to three issues:

- (i) reducing the GNI-based resource to 50% or less;

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(ii) creating ACOR with a proportion which will increase to at least 50%;

(iii) accepting a progressive contribution based on GNI.

We have to emphasize that the quantitative implications of scenario 4, namely the fact that they will be represented equally in the total of the EUB resources – probably to a 50-50 proportion in the end, will be the equalization of national contributions with the ACOR.

We should understand ACOR as being resources that derive from the exclusive competencies of the EU, as incomes from the Common Agricultural Policy (CAP) and common monetary policy. The national contributions will increase proportionally with the relative prosperity of each member state. This will require a quantification methodology to determine this prosperity which will be more sophisticated than a simple assessment of a member state's GDP.

Scenario 5, which relates to the period beyond 2020, besides taking into consideration the principles of efficiency and equity of a budget's execution in the view of an older report that was eliminated – the McDougall Report of the European Commission 1977 – brings to the table the importance of more detailed economic analysis and of budgetary practices of federations throughout the world, without requesting – as the above mentioned report did- the transformation of the EU into a federation, which is unacceptable within the foreseeable future.

The general support for sovereignty and fiscal neutrality, accepting the present own resources of the EUB, different degrees of openness and acceptability of possible new ACOR resources, differentiating and specializing criteria for good governance in fiscal collection and spending the EUB incomes suggest that developing measures to reform the EUB incomes – as viable proposals that would be assumed by the EC as an offer to member states, seems to be at a stage of difficult choices.

We are supporting this statement by the fact that the incidence of the EUB reform can always raise legislative and institutional concerns at national and Community levels, which is an issue for member states, until the process reaches a stage of negotiation based on the quantitative impact of the new orientation, acceptable when forming the financial resources of the EUB and their system.

At the same level of generalization by the European Commission, the own resources system reform points out two main directions which have considerable support. The directions involve an evolution towards a system comprised of TOR and those based on GNI, and a transition from the

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national contributions system to a system based on new resources, with an authentic Community character.

Thus, we notice that – in parallel with the almost unanimous support of the GNI-based resource, especially as a resource with a sufficient level, stable, completing and equalizing, simple, equitable and transparent – there is a possibility to discuss alternative sources that could become OR of the EUB, obviously different from the current ones.

A significant support for TOR, by accepting them through their performance criteria regarding the EUB execution, is amended by opinions according to which taxes retained by individual states as a contribution to the EUB are affected either by incorrect calculations or by high collecting costs, which consequently leads to a plea to eliminate or reduce them. In this evaluation context, opinions on gradually removing the resources based on VAT with a temporary probable expansion of the GNI-based resource for compensation needs are gaining support, as an availability reflex for a minimum reform of the EUB.

Another important conclusion, which seems to have some chances of implementation in the long-term, is– according to numerous opinions, from non-governmental sources- that of support for the financing of as large a portion as possible of the EUB by new own resources, although this option could generate significant technical and political issues.

Openness towards possible new own resources does not imply wide support for an EU-level tax, due to the institutional complications and supra-state regulation which that would imply. We have to mention that the interest for new resources is not new, as shown by a series of reports by the Commission drafted between 1998 and 2004, which generated even back then a list of possible new resources such as: an environment tax, modulated VAT, tobacco, alcohol and mineral oil excises, corporate revenue tax, telecommunication tax, individual revenues tax, taxes on income from interest or taking income from the ECB's coin issuing activity.

Regarding the evaluation of the TOR or alternative resources capable of fully satisfying the financing needs of the EUB, the VAT-based resource, corporate revenues tax, tax on engine fuel, tax on individual revenues etc – an analysis carried out while considering criteria of acceptance at a EU level, viability, sufficiency level, visibility, political and public sensibility cannot demonstrate good and very good performances.

Raising these taxes at an EU level seems simple from a technical point of view, but complicated from an institutional one. A generalized good performance as a sufficient resource raises issues perhaps of less concern

than visibility, which could be corrected more easily, but the criteria of sensitivity for their adoption, especially the weak points, surpass for now – through the possible implications, the evaluation of good performance at the level of the other criteria.

At the Commission's level, taking into account that public administrations' opinions prevail, the only future model for financing a reformed EUB, a summary of the above-mentioned scenarios, would be that based mainly on the GNI resource, gradually eliminating the VAT-based resources and the correction-equalization mechanisms. This model seems viable in the medium-term, compared with the timetable of the new MFF. At the same time, there are suggestions that – in the long-term – the financing model based on alternative resources could be debated, after extending to the upper limit the GNI-based resource.

The analysis of the five scenarios generalized on the financial aspects part of the EUB shows that it is a construction that harbors, most likely proportional to a significant degree, almost all the options related to the reform of the own resources in the wider sense of the EUB. Compared with generalization formulas of the large tendencies extracted from the multitude of opinions stated by the Commission, Romania can face options that stray from its own vision, stated in the questionnaire answers and synthesized at the Commission's level.

The EUB reform exercise remains topical through the nuance details and emphasis on differences between what is desired and what is achievable in practice, in the medium and long term, and Romania, besides having a position of principle anchored in the present reality of its stage of integration into the EU, has at its disposal an array of options to express its opinion on.

The geographic expansion of the EU with new member states was an opportunity for the difficult debates from the EU Council on the EUB, when the EU was smaller, to be attenuated by the initial challenge of a wider debate, within groups of collectivities created on social and professional criteria that greatly surpass the present number of EU member states. We could consider “normal” the fact that accumulated frustrations on the EUB theme should be dissipated before agreeing on a new MFF, with the participation of an increased number of member states.

The opportunity should be seen as raising a red flag on the difficulties of negotiations regarding the political challenges that agreeing a new multiannual financial framework at an EU level pose, as the EUB reform proposals are consecrated to the principle of “assuming,” either the traditional responsibilities until the present day on what should be a



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performance execution of the EUB (including all aspects of forming revenues and structuring expenses), with the corresponding understanding of the inherent difficulties, or by reformed responsibilities regarding the execution of the EUB, through a smooth scaling of new options for the level and structure of the traditional own resources. This would allow Romania to offer an adequate and functional response to at least one or two of the reforming scenarios of the EUB resources.

We believe that for Romania it is fundamentally important to maintain continuity of principles of solidarity and cohesion, which would allow the country to maintain a steady pace of development, close to the average level of development of the EU. This involves the preservation of the country's net beneficiary position at least in the medium-term. In addition, Romania should play a full role in the debate on EUB reform.

As such, quantitative incidences of the EUB reform over the national contribution – already identified in the modification of the TOR proportions, of the proportion of GNI-based resources, in the need to adopt in a not too distant future the concept of the ACOR and its enforcement or in the quantitative effects of correction – equalization mechanisms – become sufficiently worrisome at this very stage. Attention should focus on accepting modifications of financial resources of the EUB and, especially, on the capacity to be generated as an effect of the economic development, without excluding the beneficial impact of integration represented by the EUB.

Any quantitative simulation of the impact on the EUB's financing resources reform needs political confirmation at a community level for realism and rationality of one scenario or another, in order to be followed by a political consensus on a national level. This means that, starting from the scenarios and synthesis of tendencies as shown by those at the Commission's level, it is necessary to organize a national debate between significant partners, with the fiscal issue as one of the most sensitive ones, for public administration, for the business environment and for citizens.

The configuration stage of the future EUB reform, even if suggesting an immediate focus on the quantitative implications on the resources that constitute resources to the community budget, identifying their quantitative impact in relation to their own potential and with the benefits of the EUB execution, will help Romania not only to be active in the reform process, but also contribute to a solution for EUB reform which fits its own interest.

# **Chapter 1. DETERMINANTS AND THE FOCUS OF THE COMMUNITY BUDGET'S REFORM**

## **1.1. Justifying the priority of political implications of the EUB reform**

EUB reform, according to the questionnaire addressed to member states' administrations regarding the EU's own resources might only appear to be a technical action, but limiting it to this simple understanding is not only deceitful but also harmful. Although Romania is a member state of the EU, it remains an emergent country and still in transition regarding the maturity and consolidation of democracy and the market economy, values for which political action remains priority. Because of these reasons, the apparently technical activity to reform the EUB needs strong political support as a priority.

An evaluation of the scenarios to reform the own resources (OR) of the EUB draws our attention to the possible implications of the reform that can be grouped, in accordance with the field they aim at, as follows:

- (i) Fundamental instruments of the OR;
- (ii) Sufficient level of the reformed financial resources of the EUB;
- (iii) Distribution pattern for the national contribution to the EUB established between member states;
- (iv) Correction-equalization mechanisms;
- (v) Institutional issues;
- (vi) Stability of the EU Treaty.

Regardless of the area that the EUB reform challenges, thus implicitly becoming a negotiation subject between member states, the first connotation of the reform of the EUB's own resources is of a political nature, as it aims at a political decision to choose or support a reform scenario or a combined version.

Romania's stand as a member state of the Union follows the development of the most recent MFF, and it can be considered, probably, as the main argument to view the reform of the financial resources of the EUB from a point of view that concerns the political implications of starting one stage of switching from organizing a range of opinions in scenarios relating to the real process of reforming the EUB.

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The simple observation of the Romanian administration's answers to the questionnaire brings supplementary arguments in favor of the supremacy of political implications based on the following conclusion of the authors:

- Agreeing on the quality of the performance criteria of the current OR system is focused on qualifications of the average range, from which evaluation extremes with a connotation to total disagreement and inapplicability or irrelevance have been eliminated. As such, responses to the questionnaire rank Romania among a large number of countries that "are not completely satisfied with the current budgetary structure", according to the expression used by the EC in the "Consulting report, summary of contributions", drafted by the General Secretary and the General Department for the Budget

- The opinion of total disagreement concerns the criteria for visibility and simplicity, which calls for the need to prepare political action.

- Convenience for the largest number of criteria, i.e. vertical equity between individuals, vertical correctness between member states, legal justification, economic justification, subsidiary-proportionality, only reflect the temporary acceptance of some performance criteria, whilst remaining an issue for which improvement solutions are to be sought, which leads to political negotiation.

- Explicit agreement with some performance criteria, namely efficient allocation, effective costs, horizontal equity between individuals and horizontal rightfulness between member states reflect, in our opinion, the quid-pro-quo desired by Romania, i.e. to preserve some performance within the reformed EUB, which cannot exclude the possibility of others trying to alter those.

- A strong agreement for criteria of sufficient level and stability of the Own Resources denotes intangible factors in the reform, and the possible intent to shudder those calls for a method to politically defend it.

- In another interpretation, the strong agreement on good performance in creating a sufficient level and stability, corroborated with the neutral opinion regarding the criterion of vertical equity between individuals and the opinion of an explicit agreement for criteria of horizontal equity between individuals and horizontal correctness between member states can show the lack of intent to disturb – even in the short term – what works well in the current OR system.

- Predominance of scores below 10 for the relative importance of performance criteria, in 8 out of 13 cases, denotes an acceptance for EUB reform, thus assuming the implications included in this process.

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- The TOR, VAT-based resource and GNI-based resource have a high degree of acceptance, corroborated with a good grade for the functioning of the current institutional context and for the robustness of the statistical data, but the calculation base and administration costs are not satisfactory.

- The multitude of negative answers or appreciations of incorrectness regarding the correction, compensation and equalization mechanisms denote an opposition of Romania to previous political decisions of the EU regarding the functioning of the EUB, and reforming these areas again requires political action.

- Regarding a possible orientation of the OR system reform, options incline in favor of conserving principles, in the short term, for the size of the EUB, fiscal sovereignty and neutrality, while in the long-term it is to be expected that the issue of eliminating correction/equalization mechanisms will be solved and a stronger relationship will develop between the reform of the revenues and of the expenses of the EUB, given that the present performance of some criteria is staying the same and improvement of others is underway.

- The option to modify the institutional framework and adopt the procedures for the MFF, with relevance for the medium and long term, while completely eliminating the correction/equalization mechanisms, obviously requires political action.

- The option to deny the introduction of a resource based on EU-level taxes, in the correct meaning of the notion, reflects the very concern for political involvement at a national level. If the principle of such a resource is agreed upon, there should be an emphasis on the role and involvement of member states' national parliaments in the development of institutional procedures to introduce and collect such a resource.

An equally important issue is the need for an improved awareness, at a national level, of the fact that Romania is already involved in the EUB reform process - in the context of lively national debates, not only in the context of the current economic crisis – with respect to the issues of fiscal stability and predictability at a national level, its application, institutional and procedural functionality. Any procedure to attain the stated purpose has high chances of being immediately politicized, which affects the transparency of its complex nature.

At the same time we should avoid perceptions at a national level, often expressed in relation to how Romania's integration into the EU was negotiated, that the authorities tend to easily accept the constraints imposed upon them by the EU, having less knowledge of the institutional efforts to

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formulate and bring to a consensus the positions and the national mandate to be supported at the EU level.

Beyond the involvement of national professional associations and of civil society in the future of the European construction, with the slogan "A Europe for the citizen", we have to recall that during the debates regarding the role of national parliaments in the European construction the need to institutionalize some national mechanisms was underlined to ensure the credibility of the right to negotiate with the EU, at an administration level, especially as a member state, including as representation.

We cannot omit the national level perception, not only at an individual level, on the "juste retour" concept as an effect of Romania's accession and its obligation to contribute to the EUB resources, as the public debate still shows significant deviations from understanding the principles of solidarity and cohesion.

### **1.2. The role of the European Union Budget**

Considering the common objectives adopted, member states have given the Union rights that, over time have become more complex, taking into account the normal situation of the integration process, as well as emergency situations, when it had to react.

According to the EU Treaty, the Union acts to ensure a sustainable development of Europe, based on balanced economic growth and on price stability, in a social market economy with a high degree of competitiveness, with high levels of employment, and social progress. Equally, the Union aims to give high priority to improvement of the quality of the environment and to promoting scientific and technical progress.

To follow and attain the objectives set out by member states, the European institutions need financial resources, for their own operation, and to finance the achievement of common goals, with the Community budget as the instrument decided upon at EU level.

To accomplish common goals and ensure success for the applied policies, starting from adopting appropriate systems of economic governance, the Union divided the tasks between itself and member states, based on the principle of subsidiarity, cohesion and solidarity.

The EUB reflects these principles as follows:

- concentrating the resources of the community on a few major initiatives;
- ensuring financial transparency;
- improving the quality and efficiency of expenses;

- an evaluation which is as effective as possible of the added value of the EUB at an EU level;
- consistency between different strategic objectives/goals and financial instruments;
- developing a partnership with all parties involved, both at an EU;
- level and between member states.

To maximize the performance of the EUB it is necessary not only to have solid cooperation and partnership, but to have simplified procedures that would create a synergy of the variety of powers that make political decisions, at local, regional, national and EU level. This was proven possible by a visible interaction between objectives and budgetary means, available and executed, at an EU level and member state level, corroborated with a correct evaluation of the national contributions to the EUB.

The role of the EUB gained the expected credibility as the budgetary instruments responded better to the criteria of simplicity, consistency, efficiency and transparency. The simplification of the budgetary structure was seen as a permanent necessity, to eliminate duplications and redundancies, while, in parallel, the Community institutions ensured member states the proper instruments to control the accumulation of contributions and the expenses of resources with a Community character.

### **1.3. Introductory issues pro-memoria regarding the reform of the community budget**

The EUB reform, as a political action, is under development, with Romania included in the ongoing process. At the date of accession, January 1, 2007, some of the stages, for summarising opinions on budget reform had been completed. Collecting these opinions, generated by a diversity of partners (the public and/or governmental sector, nongovernmental organizations, private sector, universities, independent researchers and citizens), offers the benefit of understanding several approaches and attempts to systematize them, so that they can be taken into account in the negotiations on budget reform.

Certain and important for Romania is the fact that EUB reform is politically desired, relatively advanced from a technical standpoint on the European Commission drawing board, and has the motivation of the evaluation of the current system for ensuring and spending of financial resources efficiency. The EUB reform is in a program that has good chances of incorporating the orientations agreed upon, in the medium and long term,

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in the financing mechanism of the EUB, including institutionally and normatively, if the situation calls for it, and to be implemented in practice.

The moment of the first change in the process of reform of the EUB is expected to be 2013, a year that coincides with the end of the current multiannual financial framework (MFF). The second moment could be 2020, which involves the development of a new MFF, in accordance with the normative framework and with the basic and accomplishment mechanisms, possibly reformed in mid-term, of the budget for a cycle of seven years (until 2020).

According to the Lisbon treaty, some reforms to the EUB could take place sooner, under pressure either from external challenges to the EU, or from internal choices based on the free will of the member states.

We should emphasize that the present mechanism and structure of the EUB have followed an historic path from simple to complex, strengthening the idea of a continuous improvement process and the need to adapt to the three development dimensions of the EU: geographical expansion, enlargement of the managed areas, and enhancing the process of integration.

From a purely administrative budget to financing priority policies, from the prevalence of a budget designed to develop agriculture – with the CAP as base – to a budget that would respond to the needs of cohesion and solidarity with ever-growing emphasis on economic growth and employment, all mark a process of continuous efforts dedicated to a community budget that would be appropriate for the internal and external objectives of the EU. The desirability of an EU budget that would encourage competitive economic growth and adequate employment has become most relevant during the current financial crisis, which has had a significant economic impact throughout the EU.

### **1.4. Temporal moments of the EU budget reform**

The second half of 2006 saw the intensification of debate on the EUB reform process. The discussions took place at an inter-governmental level, as well as in the academic world and in civil society, stimulated by political decision of the Council of the European Union, taking into consideration the level of representation of member states within this EU decision making body.

The initial point of this process is related to finalizing the financial perspective 2007-2013 (in December 2005), when the Council of the European Union, at a level of heads of state and government, invited the

European Commission to make an evaluation of incomes and expenses of the Community budget, as a basis for a possible revision. The results of the evaluation were scheduled to have been published in 2008-2009.

The debate on possible reform of the budget required contributions and necessitated a detailed dialogue between member states on the future political objectives of the Union, which would support the economic development and employment of the work force for an expanding EU. By the time of the first evaluations of the results of the debate, September 17, 2007, the President of the European Commission and the European Commissioner for the budget had presented the document “Reform of the budget for a changing Europe”, and this was also the launch date for the public consultation process with regard to the community budget reform”.

The public consultation process was started by the European Commission by inviting all interested parties, at local, regional and national levels, and the contributions were expected to help the Commission to prepare a “White Book” on EUB reform. The White Book was intended to be debated by member states in 2009 and 2010.

Romania became an active partner in the reform process, and began to make a significant contribution once it had joined the European Union on January 1, 2007. As far as the timetable of reform of the Community budget is concerned, Romania has been presented with a “faits accomplis”, which places it in a sensitive position, characterized by the ex abrupto confrontation with strong traditions and heritage, reflecting the dynamic balance of forces within the European Union, existing since before the geographic expansion. Romania has joined at a time of new competition opened by new countries, incorporating not only the national expectations and objectives of new member states, but also the challenges created by the most recent strategies of the European Union, especially the Lisbon Strategy, and the institutional transformations included in the new Constitution Treaty.

At this crossing of interests – we are talking about the moment of Romania’s accession to the EU – diversified as numbers, as partners, opportunities, policies, strategies, visions, expectations, challenges etc, we cannot omit the corresponding reflections on Romania’s objectives.

Continuing the European construction, this time from within the club, includes the perspective of the European Union’s own financial resources, which can become one of the main factors that will determine the course of European integration, in which the expectations of European citizens have been invested, including Romanians. Thus, we believe that



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Romania should not face difficulties in making an active contribution to the debate on EUB reform, even though it is a newcomer.

### **1.5. EUB reform – a focus for political confrontation**

Seen as an important instrument that the EU uses to accomplish its political objectives, the community budget is, at the same time, large in quantity in terms of its absolute value (over 100 billion euros), but also very small when compared with cumulated public expenses of member states (approx 2.5%).

Conceived as successive multiannual financial frameworks after 1980, the budget increased in real terms in the period between then and the present, but its size compared with national budget incomes has decreased, despite the EU expanding and assuming new objectives. Even though the size of the budget has remained modest, it has still been the focus of political confrontation, and periodic crises. This demonstrates the high political stakes related to the EUB, both for the European Commission and for the member states.

EUB reform should lead to a new consensus on the orientation of the expenses policy of the EU with impact on a possible structuring of the own resources, in such a way that it can respond to the challenges of the next ten years and beyond. Without supporting the constraints of a new negotiation regarding the present MFF, EUB reform is an opportunity for new political confrontations, even more predictable as the budget revision, as a political action, will implicitly lead to proposals for a new MFF for the period beginning 2014.

Although the task of globally dimensioning the new financial framework belongs to the new Commission, once its president is elected, the structure and orientation of the future priorities of the Union with regard to expenses, though set out by the Lisbon Strategy, raise the issue of positioning and benefits expected from the added value of the reformed budget. The consensus for a balance between national interests objectively needs to go through the stage of political confrontation towards a consensus of community will, which stipulates a corresponding technical training to argue the national political position.

We can accept that this stage has important marks to report to the probable changes' tendency for the already known priorities, and in particular for Romania there are no consistent evaluations for those changes where there is no functional territorial continuity – on Romania's territory –

for some categories of expenses that support policies which generated no benefits.

Relevant for this situation is the definition of the fundamental reform of the EUB, the European Commission being invited, through an agreement between the Council of the European Union and the European Parliament, “to realize a complete and global revision that includes all aspects related to the EU expenses, including the Common Agricultural Policy and that of resources, including the compensation in favor of the United Kingdom, and to create the report for 2008/2009.” From this definition we can clearly understand particular cases and corresponding policies.

We should also keep in mind that the substance of the political battle for EUB reform is inspired by the political agenda of the European Union, obviously undergoing a profound modernization phase. Globalization has brought new challenges, and issues such as climate change, energy, and migration have reached the center of the European debate. Following the present financial crisis, innovation, new response capabilities and a motivational business environment are now more than ever at the heart of the strategy for economic growth and employment in Europe.

The same globalization requires a better design worldwide of interests and values which represent European culture, with actors and custodians that are the citizens of the continent. EU expansion generated expectations of raised living standards in the new member states, which strengthened activities to promote social, economic and territorial cohesion.

All these changes, noticed and assumed through community policies are naturally viewed in different perspectives in the minds of citizens of each member state, while the national policy resulting from the citizens’ votes should accommodate an even larger number of national goals of other states, convergent as principles, but potentially divergent when it comes to ways to transpose into action in the process of implementation of the EU-level policies, implementation within which the EUB plays an essential part.

We should assume that the elimination of the quantitative references for the new multiannual financial framework, at this stage of configuration of the EUB reform, could make the political debate on objectives and overall revision of the budget even more difficult.

### **1.6. Objectives of the EUB reform and their nature**

The moment when Romania joined the debate on EUB reform allows us to formulate its objectives in the light of the most recent statement of the position, at the EU conference, “Reforming the budget, changing

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Europe”, on November 12, 2008. It is important to remember that the objectives package revolves around the need to develop a strategic vision of maximization of the added value that the Community budget can produce.

This strategic vision is conditioned on its association with the fundamental principles, identified as objectives of the reform, which guide European integration, as a consolidated structure, which is well developed and attuned to the needs of the citizens of the European community:

(i) focusing the budget on those policies that respond best to the main challenges that the EU faces;

(ii) completely aligning to the mechanisms of subsidiary and proportionality;

(iii) a permanent optimization of efficiency, economy and responsibility in the spending of the community budget.

There is an opinion that the spending pattern of EUB incomes has tended to stray from the political agenda set by the EU in recent years, confirmed by the admittance of failure to reach in due time the objectives set by the Lisbon Strategy. This means that there is a need to focus on new fundamental measures to apply the principles, which would overcome the difficulties mentioned above and, especially help to make the functioning of the EUB more efficient.

We underline that the reform of the EUB, for the time being, does not represent an administrative exercise, of pure accounting, which brings changes in the title of incomes chapters of the community budget, draws attention to the primarily political nature of the approach to reform of the EUB, since it offers a chance for possible base modifications, from the highest level of support of the political national will.

That chance should be maximized by supporting a national position with consensus on orientations and structures in the medium and long term of the economic and social policies of Romania, beyond the electoral cycle, with impact over at least one cycle of the MFF, that from the immediate future, following the objective of net beneficiary and of maximizing the added value of the EUB in our national interest.

Moreover, the political nature of EUB reform, through the invitation to significant initiatives on the national contributions of member states, is an opportunity to formulate a new national strategy for economic and social development in the medium and long term, in line with the new challenges of the changing world and Europe after the present financial crisis.

The documents of the European Commission refer to the present challenges which the Union is subject to and systemically looking for

political agreement of member states to answer those with common policies. Applying the common policies in the initial phase of implementation complies with the principles of subsidiarity and proportionality. The final results, though, usually reflect distortions created by the differences in political and technical capacity to support national projects that require Community funds.

Besides a national contribution to the present challenges of the Union, as a foundation for EUB reform, focused on increasing European competitiveness, climate change, access to primary and energy resources, alternative energy sources, energy security and efficiency etc, we should stress the political competition at a community level to “slice” the EUB, into projects of the same nature initiated by several member states, just as common policies can be disproportionately implemented at a regional level due to the same issues of political support capability.

It is obvious that there will be a tracking of the intervention methods through the EUB on large scale projects that involve, for example, diminishing the negative consequences of economic activity on the environment, of infrastructure construction where lacking in the European energy supply system, of developing the knowledge based society by involving research infrastructure, mobility, excellence etc, but we can expect the same disproportionality over what claim to be contributions to increase the efficiency of cohesion and solidarity, another fundamental principle of the Union.

Hence, it is even more obvious that there is a need for a new strategic national vision in the long term, with an extremely well documented incorporation of objectives that respond to the general challenges recognized by the EU, thus ensuring that Romania’s specific objectives would benefit from Community funds as a net beneficiary. This vision is even more necessary as the financial crisis has proved that the current inter-dependent world is less organized than previously thought.

The appearance of a better organized world at an EU level cannot be supported other than by the principles of subsidiarity, proportionality, cohesion and solidarity, on which Romania can still count, but only through involvement. The EU is the guardian of these principles and they should inspire us in our approach, behavior, European activism and as contributor to the European construction as a member state. But, we should not omit the fact that between the acquisition of the *acquis* as a norm and the practical action in the spirit of the assimilated norm there is an educational objective delay, which should be recovered by norm. Romania now suffers from these delays, when we talk of legislation and enforcement of laws, generally, but

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the EUB reform, especially, can become the opportunity for a real exercise, important and significant of the alignment Romania needs in many areas.

Following the example of public consultations on EUB reform, assumed by the European Commission – a reform initiated by political will – the same course of action should be assumed and continued at a national level throughout the entire process, until the stage of negotiations. It is acceptable to nuance the way and role of development in Romania of the public consultations on the community budget reform, which we will develop during the chapter of public perception of the EUB. However, we note from the very beginning that respecting the essence of the consultation, in the spirit of the EC recommendations, is a necessary condition for the Romanian authorities' success in finalizing our own action dedicated to EUB reform.

Satisfying the need mentioned above has the quality of not affecting, perhaps at the most unfortunate moment as opportunities are concerned, the credibility of the confirmation offered by the political factor on the national objectives assumed specifically by the government, on which the arguments for reform of the EUB in the national interest, are based and, secondly, the ability to directly offer political support to the reform, by the head of state and/or government at the time called for by the schedule set by the European Commission at the Council of the European Union level.

This order of events has a positive impact for the stage of technical negotiation, on numbers, that should follow the political option for one variant or another of an initially qualitative reform of the EUB. The final quantitative matrix of the reformed EUB financial resources' matrix will have a better response to attaining national interests, on the basis of and within the objectives set by community policies.

This reciprocal assimilation of national and community interest, after a first success of Romania's contributive exercise on the reform of the instrument created to ensure a viable implementation of the EU policies, should be looked at as a continuous process. As of this moment, we believe that the assimilation mentioned above calls for an alternative synergy between the political and technical approach, and each type will be used at the qualitative as well as quantitative moment of implementation, to a certain level of decision making – Commission, Council, Parliament.

We believe that the interest shown by the European Commission for the EUB should be interpreted as a political moment, which means that the technical or methodology nature of the impact of reform of the EUB reform

on the financial contribution of Romania to the community budget should generate internal political decisions that focus on at least two major issues:

a. the aim of carrying out political lobbying in Brussels to support the variant of the EUB reform which suits Romania best, in terms of the level of its contribution and its interests.

b. the aim of a better inclusion of the community budget's principles in the construction method of the national budget, from a perspective of a better compatibility with the effect of diminishing possible shocks of the reform's impact (considering the multi-annual character of the community financial framework), and of an easy continuity of Romania's contribution to supporting EUB reform, to which a contribution has been made with the country's own political vision, generated by a national development strategy that uses the EUB's resources.

In conclusion, the implications of modifying the current system of ensuring the EUB's financial resources exceed by observing their political nature, the simple impact on the way Romania's contribution to the EUB financial resources is formed. There are also implications related to other levels of organization and social vision of Romania, the EUB presenting itself as an opportunity to set in motion a national mechanism which fits its capacity as an EU member state.

### **1.7. The meaning of EUB reform**

The meaning of the community reform should be looked at as multidimensional, which is, possibly, the main cause for possible difficulties which could accumulate towards the end of the closing period of the current EUB reform cycle, preceding the actual negotiations between member states for the future MFF, starting from one of the configured scenarios.

The way to set off the entire reform process, starting from an evaluation, gives us the possibility to identify some of the positioning aspects of national requirements. They reflect mainly the freedom of approach, reform points, constraints of the treaty, reflecting and/or promoting national interests through the exercise of the community budget reform.

#### *1.7.1. Freedom of approach*

This aspect is one of the most important ones from the point of view of innovation and creativity that characterizes, in fact, the entire process of European integration, through the political lead and pillar of the entire process, as an expression of the parties' will regarding the essential

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objectives of the EU, which presently focus on the Lisbon Strategy: a Community economy that will become the most competitive and dynamic in the world, based on knowledge.

We note, out of the category defining the freedoms of the EUB reform, the following stimulant characteristic of the approach:

a. setting the process as internal will of the EU institutions, as the initiative was validated at the Council of the European Union level (December 2005);

b. the European Commission leads the beginning of the process – as effector, starting from an inter-institutional agreement with the Council of the European Union and the European Parliament (May 2006);

c. public and institutional consultations take place within an overall estimation of the community budget, which denotes not only the necessity of reform, at least as stated objective, but also the freedom of profound uninhibited involvement;

d. The evaluation of the budget, equally as a political and technical instrument should be exhaustive, which strengthens the unique character of the opportunity offered for the reform and, as such, this opportunity should be used to its full potential;

e. Reviewing, as fundamental evaluation, of the budget is free of constraints, especially putting forward, on this occasion, a financial or negotiation framework, which has always proved difficult;

f. The fundamental re-evaluation of the budget focuses on the configuration of its role in the consistent formulation of Union common policies, which will respond to the challenges of integration for the next few decades, and, in the present, to the financial crisis;

g. The fundamental review is based on a new synergy needed to match the common objectives and action directions of the Union, prioritizing the expenses of the community budget, which calls for a new qualitative correlation between policies and the financial resources that it should support;

h. The concept of budgetary efficiency is reiterated at a superior level regarding the added value and actual results that the Union's expenses can present;

i. The reform of the budget appears as necessary and from the point of view of the budgetary instrument functionalities, at a time when their continuity could be confronted with the danger of a discontinuity brought by future challenges; this space must be filled by a corresponding balance between future geo-political and geo-strategic actions, proposed by the EU

as its own objectives and based on the real external realities that the EU must face.

The openness to a far reaching reform, although it can be tributary to the conservative tradition of the community well-known in the EU-15, could be assigned to the benefit of the freedom of initiative that would belong to the 27 member states, from whose multitude we could find on the table of negotiations that number of proposals or variants that will either ensure the balance between policies and their correct price or will state the cost that should be undertaken by the contributors to the budget to implement the policies of the Union that were agreed upon.

### *1.7.2. Regarding the points of the EUB reform*

If we see the reform points attached exclusively to the financing of the community budget, they surpass in some ways the strictly technical elements. We justify our statement with the conception behind the study ordered by the European Commission, and the GDB, and carried out by the London School of Economics and Political Science.

The study relies on the document published in 2007 by the European Commission regarding the results of the consultation stage at the level of member states, which generated a set of practical questions and identified the order of the debate.

The structure of the questionnaire and, especially, the answers presented the Commission with a few basic issues regarding the reform points of the budget. The visible orientation towards the future financing resources of the community budget does not obstruct in any way the major interest in establishing a pattern for the purpose of the expenses, but three major areas of interest were discerned from the assumed balance of opinions regarding both funding the Community budget, and its expenses:

- The principles of improving incomes by mirroring these in the own resources system typology;
- Correction and compensation mechanisms;
- The legitimacy and transparency of the current financing system of the community budget, an issue raised by the European Parliament.

We are practically facing three different ways of possible “alteration” of the current budget system of the EU: conceptual, operational and political, which demonstrates once again the need for a multi-disciplinary approach of the implications of each reform point and ensuring the widest possible public consultations.



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### *a. The principles of improving the EU budget resources*

There are two major legal constraints regarding the principles of constituting the resources, namely Articles 268 and 269 of the Treaty of European Communities: these refer to the OR in a broader meaning, to how they are set, adjusted in the situation of net contributors, mechanisms for guarding against excesses, and the requirement that revenues should balance expenses.

The constraints currently in place essentially demonstrate the need for the EUB reform to start from the current system to ensure, first of all, the transition through continuity towards a possible system of higher performance. As such, we should avoid a less structured reform, knowing that the system is formed of components that should continue to couple, and the changes that are to follow should maintain this principle.

Secondly, the principle of a sufficient level of revenues remains a landmark of any budget, noted in all the financial literature, but it should not be seen as an insurmountable obstacle in the sphere of political debate related to improving transparency and responsibility for expenses.

Thirdly, the principle of resources directly collected by the Commission and that of the resources included under the term of transfers continue to remain a subject of debate, and the reform of the budget could bring new conventional explanations, if not direct clarifications.

Fourthly, the principle of correlating the EU policies that should be financed, as expenses, and the rationality of resources as revenues should make a distinction between:

- specific financing sources for explicit expenses;
- specific financing sources that are included in the overall expenses;
- the correct application of the principle of subsidiarity, meaning that the budget expenses for actions at a EU level bring additional benefits that are notable in comparison with the same actions at the level of member states;
- a member state should refrain from requesting EU funds for actions with effects that are primarily local and to which it has full responsibility;
- the co-financing ratio should reflect the justness of the balance between interests and political will between a member state and the Union, starting from the principle of subsidiarity.

Last but not least, the principle of explicit normative criteria should guide the EUB reform, ensuring that the member states are fully aware from

the very beginning of the institutional impact, which is significant in some cases of modification of the current financing system of the EUB.

*b. Mechanisms of correction, equalization and compensation*

Mechanisms of correction, equalization and compensation should be treated as an effect of the political approach on the overall execution of the Community budget, as they are the technical expression of assimilating in numbers the political acceptance of a national contribution to the EUB. In essence, we should note the contradiction between the relatively easy compromise for the Union common policies and the difficult compromise on the community budget's numbers that should transpose these into reality.

As shown by the difficult compromise reached while establishing the 2007-2013 MFF, we should expect confrontations on at least three different issues in the future:

- limiting the increase of revenues to the community budget;
- the setting of the level of contributions by each member state, with the highest contributors usually being the most vocal critics of the process;
- some community policies that have caused dissension for years on the direction of some expenses – with the CAP as the most important example – and now, after EU enlargement, dissension on regional aid, with increasing competition for structural and cohesion funds.

The countries mentioned, with implications for the applicability of correction and compensation mechanisms are, in principle: Great Britain, which uses a rebate of its contribution, obtained as a political decision when Margaret Thatcher was the prime-minister and which insists on gradually eliminating EUB subsidies, applicable through the CAP. Germany, the Netherlands and Sweden criticize the total increase of revenues to the EUB, which mean that they are faced with having to make larger contributions to it. France opposes a fundamental reform of the CAP. The implementation of the Lisbon Treaty can, in principle, be expected to make the political debate dedicated to finalizing some stages of the EUB reform even more difficult.

Many analysts who monitor EU financing area consider that the member states, as a whole, desire a community budget that will assist in achieving the objectives of the common policies agreed upon, as was the case, for example, with the assistance granted to countries near the Union and which later joined, or to the implementation of a research and development program at an EU level. But, individually, the member states are cautious with regard to the net level of their financial contributions to

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the community, as a difference between their input into the EUB and gains through the CAP or other Community policies associated with subsidy mechanisms.

As there is no technical formula to reach an acceptable net position, there is a tendency from member states to “manipulate” Community policies so to be able to demonstrate to their national parliaments and, finally, to their citizens, that they receive a fair amount of EUB funds, and if not, they request rebates.

The correction mechanism, as it presently works, leads us to the assertion that the annual budgetary execution proves, many times, the insufficient focalization on objectives, its excessive bureaucracy, inefficiency and, perhaps the worst part, that possible political battles won when the national contributions are set – during the preparation, negotiation and approval of the EUB MFF – are lost when the community budget's expenditure is closed.

The political relevance of the correction, equalization and compensation mechanisms is related to the importance of any rise in the level of EUB revenues, as any increase in the Community budget means supplementary pressure on the treasuries of member states with large gross contributions, and any decrease means depriving other member states of the financial benefits of applying policies such as on agriculture, regional development, increase of funds dedicated to research etc.

The path of the political debate is given by the country that holds the presidency of the Council of the European Union, and for Romania, as a new member state of the EU with high expectations of achieving some objectives that concern its own interest by using the common policies of the Union, bilateral consultations are beneficial both with the large contributors to the EU budget, and with the countries that are likely to be influential in the decision making process on the next budget.

The basic dilemma of the EUB will remain what exactly the budget aims to achieve. If we analyze spending under the EUB, the political objective of the EU seems to be more to ensure acceptable net positions for all member states, and this can make it difficult to attain the goals of agreed Community policies. Confronted with this dilemma, Romania's options are:

- (i) to argue for a significant redistribution of funds through the EUB, from some states to others;
- (ii) to promote Community level objectives under the EUB, which will bring benefits to the largest possible number of contributing states.

The political analysis so far indicates that, for now, a mix between the two options seems impossible from the point of view of the overall efficiency of the EUB. The political argument for the first option is technically reduced to the lack of competition in accessing funds (for example, the research funds distributed on a competitive basis represent a very small part of spending under the EUB). The political argument for the second option - that common policies offer a more secure food and energy supply and strengthen cohesion and competitiveness in the EU – degenerates technically into a simple redistribution of the community funds from some states to others, which only complicates the debate and postpones decision making.

*c. Legitimacy and transparency*

The entire European construction process has been marked by political discourse with the aim that the European citizen should be made aware of the benefits not only in a passive manner, but also should become actively involved in the development of policies and should be encouraged to have an opinion on the acceptability of costs compared with the expected results. Last but not least, the Community's executive institutions must take responsibility for the manner and efficiency with which the individual financial contribution of each member state is spent.

In this context, the issue of legitimacy of the resources for the Community budget and the transparency of expenditure has always been one of the guiding principles behind the financing of the budget and its expenditure, both at Community and national levels, the latter being the most sensitive of the two. The culture of the two principles is relatively new in Romania, and the crisis gives even more importance to their popularization among the citizens. This is even more critical as the public discourse since accession has focused on the asymmetry between Romania's contribution to the EUB and the benefits in terms of the amount of Community funds absorbed.

The legitimacy of Romania's contribution to the EUB should not be seen as a simple automatic result of the accession treaty. The political commitment to making the national contribution to the EUB is based on the understanding of the need for the EU to function with Romania as a member state.

At its core, the legitimacy has a complex significance, and it involves a national effort to support the financial resources of the EUB, expressing an act of adhesion to both the financing of the common objectives of the Union, and to the legitimate expectations of real results of

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those objectives at a national level, as a true reflection of European cohesion and solidarity.

This legitimacy originates from the political endorsement of governmental programs by the national parliaments of member states, which are increasingly related to wider programs at a European level.

The growing involvement of EU programs in national government policy, particularly as there is a need to catch up, has the advantage of raising awareness of the costs and benefits of Romania's membership of the EU.

The institutional legitimacy of Romania's contribution to the community budget calls or should call for a wide ranging political debate, starting from the basic obligations stipulated by the accession treaty. To have legitimacy, the uses and probable benefits of the EUB's expenditure must be transparent, and reach the level of the citizen.

We should not forget that analysis of polls regarding the openness of Romanian citizens towards European integration, prior to accession, showed that enthusiasm prevailed over knowledge, and benefits over costs. This situation has seen radical changes because of the application of the *acquis communautaire* in practice, the free circulation of the work force, and, especially, by the involvement of politicians through their presence in the legislative mechanisms of the EU.

Transparency is a most important factor in giving substance to the political debate dedicated to granting legitimacy of the national contribution to the EUB, through the fact that it delivers knowledge, in a natural way of the principles and role of the EUB in achieving the common objectives – programmed or effective – from the point of view of the Community institutions.

At the same time, applying the principles of legitimacy and transparency of the Community budget at a national level ensures that there is cross-checking between its legality and opportunity, especially when we are talking about extra-territorial public financial contributions, with international management, and of which many citizens can be particularly suspicious.

### *1.7.3. Positioning Romania*

Reiterating the idea that the fundamental re-evaluation of the functioning of the EUB's current system is a great opportunity for Romania, the reform of the community budget can bring modifications, enhance or weaken the arguments that the political arena used to justify accession: dividing responsibilities within a larger Europe, including by the benefits that the EUB offers member states.

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In this context, another basis for Romania's position, besides that represented by the constraints of the treaties, is represented by the main events observed in the implementation of the EUB in the past five years.

The balance sheet of these events, including the 2004-2009 period, shows aspects that cannot be omitted from Romania's contribution to EUB reform, inspired by national interests. They represent important promotional vehicles, as they appear to be landmarks of the EUB configuration for the European future of all member states.

The following balance sheet items of the above-mentioned developments are noted:

- The political decision of a fundamental reform of the EUB is in the stage of reaching consensus through the analysis and possible adoption of one of the scenarios for the reform of the EUB's own resources.

- The political agreement that permitted the validation of the 2007-2013 MFF, which provides for expenditure of 975 billion euros, a framework that proved wise as far as ensuring the financial stability of the enlarged Union goes, and marking the entry into a new generation of programs that reflect the new internal and external factual realities.

- 2008 saw an increase to 45% of the ratio in the EUB of expenses to increase competitiveness, economic growth, creating jobs and other policies that accompany these objectives. This new level reflects the dynamism in the execution of the EUB, which is turning into an instrument capable of efficiently responding to new challenges.

- Introducing the new ABAC (Accrual Based Accounting System) and of the International Public Sector Accounting Standards (IPSAS) allowed the Court of Auditors of the EU to grant, for the first time since establishing the Community budget, a certification without any qualifications of expenditure under the EUB for 2007

- Introducing a preventative alarm system that allowed spending under the EUB to be much closer to the levels budgeted for, which led to a reduction of almost 90% of the budget surplus during the last mandate of the European Commission.

- The new Financial Transparency System (FTS) made possible, for the first time public online access to all allocations and beneficiaries of funds (structural and agricultural) awarded by the European Commission or its specialized institutions.

Remembering these details, which are fairly technical but with a connotation of political responsibility of the European Commission as effector of the EUB, it is important to measure the argumentation of the national position, including the concentration of the political effort, at least

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in the medium term, on the benefit of a net position, concentrating on features of national interest that are yet to find operational solutions at a community level on the effect of delayed propagation, at a national level, of the adopted common policies, including those stated in the 2010 strategy. These positions can offset the approval to reform the EUB as restructuring the own resources in the national financial contribution.

### **1.8. The strategy of annual policies for 2010**

At the beginning of each year, the European Commission communicates to the European Parliament, the Council of the European Union, the European Economic and Social Committee and the Committee of Regions the strategy of annual policies for the following year. The purpose of the document is to set a work agenda and launch the European inter-institutional dialogue regarding the priorities for the year to come.

The document is comprehensive, surpassing the issues of budget allocation for the respective year, though those issues exist. From this perspective, knowing its content is relevant, it should be noted that starting in 2010 the process will start to reach a consensus on the main policies that configure the future MFF under the new mandate of the EC.

Proposals for priority policies of the EU, as well as those regarding the general framework of financial and human resources developed through the strategy of annual policies for 2010 bring to Romania's attention commitments already undertaken in the two years since accession, with impact on the orientation of the EUB's expenses in 2010. Positioning Romania on the issues of the EUB reform should take into account the priority policies already under implementation and with financial support, the current level of the resources and the efficiency of spending becoming an indication of the future proposals of conservation, increase or diversification of the budget resources for the future MFF.

The priority policies remain within the tradition of the integration process with the objectives orientated towards cohesion and solidarity, but, at the same time, are following the most challenging realities of the present, namely the consequences of the developments during the current crisis. The rationale of their structure follows, in our opinion, the new logic to use solutions as defined, including with the contribution of the EU, by the G-20.

As such, with respect to the weaknesses and vulnerabilities of the current MFF, outlined by the crisis, 2010 should bring forward those ongoing developments that will influence the concept of the future MFF

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from a point of view of the EUB expenses, while benefiting from the reforms to be adopted.

In order of priority, these are as follows:

- Economic and social recovery; a priority policy that ensure an effective follow-up of the European Economic Recovery Plan, according to which the member states will continue to fulfill their commitments and coordinate their efforts to bring to life the Lisbon Strategy regarding economic growth and employment, and to preserve the principles of the Stability and Growth Pact.

- Climate changes and a sustainable Europe, a priority policy that derives from the EU commitments, according to the new international agreement on climate change, creating a path for major investments in the long term, with effects of technological progress in areas such as reducing emissions and the greenhouse effect, the development of alternative energy and improving energy efficiency.

- Citizen before all; a priority policy in the first year of implementation in 2010, according to the Stockholm program for freedom, security and justice.

- Europe – partner of the World, priority policy regarding two essential aspects: a conduit designed to face the challenges of globalization, energy security, food security, climate change and of migration, as well as involving the EU in aiding poor countries in their recovery after the current crisis.

- Better regulation and transparency; a priority policy aiming to simplify Community legislation and bureaucracy, without affecting the efficiency of its quality for the targeted objective, including the continuation of the actions included in the European Initiative for Transparency (with a direct referral to the beneficiaries of EU funds), and applying the results of the evaluation to the functioning of the Registry of interest representatives and the implementation of the One-stop-shop Registration procedure.

We should mention that on June 22, the Budget Committee of the Council of the European Union adopted the draft budget for 2010, as it equally reflected the positions expressed by the delegations of member states in the two rounds of negotiations, with the note that Romania has reached its main objectives, especially on allocations regarding subchapter 1B, Cohesion for economic growth. Starting from this point in the process to adopt the commitment allocations and of the payment allocation of the EUB for 2010, it can be seen that Romania responds to the qualitative initiatives regarding the future multi-annual financial framework (MFF) and which enjoys political support at EU level. The natural conclusion is that



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Romania takes an interest in the process of reform of the community budget.

### **1.9. The main tendencies to conceptually and technically reform the EUB as resulting from the public consultations**

At the end of 2008, the Commissioner for financial programming and budget, Dr. Dalia Grybauskaite, presented the main conclusions generated by the public consultations on EUB reform. Their authenticity is confirmed by the fact that each member state sent its official contribution based on questionnaires, that more than 2000 people from 20 member states debated the issues related to EUB reform and that more than 300 specific contributions were received with regard to a variety of aspects related to the reform.

As identifiable partners, 34% represented the public/governmental sector, 20% non-governmental organizations, 14% the private sector, 13% universities/research, 12% citizens, 7% others. This diversity confirms the European interest in a fundamental reform of the EUB, and for the need to change.

The public consultations have produced some relatively strong common views, as follows:

- the community budget is the main instrument of response of the EU to a changing Europe;
- the rapid modernization of the EUB is the EU's chance to confront new risks and challenges;
- the essential measure of the EUB's efficiency is added value to be brought to a European level; added value is the main criterion that should be the basis of any expense at the EU level;
- the "juste retour" concept at a level of member state should be eliminated as using it would mean not only a never-ending debate, but a total undermining of allocations, either committed or to be paid.

Concerning the challenges the EU faces, which should have a conceptual and operational representation in the EUB financing system, the opinions stated reflect the following, in the order of priority:

- climate change – two thirds of respondents state that tackling this issue is a test for the future of Europe;
- increased competitiveness in the EU – one in two respondents said that this should be a priority of the Union, in the global economy;
- ensuring security of the energy supply – a priority for economic growth and employment in the long term;

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- inequity – in a broader sense, existing between countries and regions is a reality which needs to be tackled;
- aging population – has implications that should be approached at a European level;
- external factors – mainly migration and security threats, are generating increased pressure on the European Union.

Based on these messages and the order of these challenges to the EU in terms of their importance and their immediacy, the following are possible future uses for the EUB's expenditure:

Areas for which survey participants said expenditure should rise:

- expenditure to ensure competitiveness, based on improving research and development at a Community level: respondents called for a significant increase in funds directed to Research and Development at a Community level, with financial support for innovation in industry and business;
- expenditure on environment protection and reduction of the effects of climate change: here there was support for increasing the funds and focusing on Research and Development to meet environmental objectives, and on aligning policies to the requirements of a clean environment;
- expenditure for energy development: dimensioning this should cumulate issues of supply security, targeting support for alternative energy projects, focusing the research on technologies to efficiently produce and consume energy, as well as orientating direct expenses to the development of renewable energy sources.

Where expenditure should stay the same

- expenditure on cohesion: support for this principle remains strong, but there is a notable level of support for changing the application policies, with the proposals focusing on concentrating funds for the least developed states or regions of the EU, ensuring a faster economic convergence, and turning the cohesion in action into an answer to the challenges of globalization.

Where expenditure should fall

- expenditure on agriculture is considered a hotspot of the debates, as together with that meant for the implementation of the cohesion policy it uses up two thirds of the EUB: CAP should be kept by aligning it with new common objectives, while reducing allocations as direct aid, and those still existing should meet some real necessities of rural reform, participants said;
- financing rural development: should be perceived in the context of the cohesion policy, which would reduce pressure on the PAC-reserved

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expenses; it is proposed to enforce pillar 2 and find a way to co-finance pillar 1.

The summary of opinions on what EUB expenditure should focus on, starting from restructuring the priorities of the common political objectives, allows us to draw some conclusions about how the budget should be financed. The most significant amount of support is for the principle that the EUB financial resources should be appropriate to meet the "ambition" of EU politics. Thus, there is a recognition that common policies need adequate financing, but this does not necessarily mean straightforward support for quantitative increases in the EUB's financial resources, either in absolute terms, or as a percentage of the EU's total GDP.

On this idea of matching the financing against the scale of the policies envisaged by the European Union, through the consensus of the member states, we can distinguish the following restructuring tendencies for the financial resources of a reformed community budget:

- TOR of the EUB enjoys significant support, which could prevent orientation towards alternative resources;

- The contributions determined on the GNI are considered to be the safest and the most functional resources, thus their institutional approach could be extended in time;

- The contributions determined on VAT will have to be eliminated in time, a process which will be combined with a simplification of the system to extract and correct the basis of calculation;

- Alternative resources enjoy not only an accord of principle, meaning that possible proposals could be debated, but also that the examination of the possibility to apply them should be carried out in a close relation to the priority policies of the EU, involving possible institutional changes.

The correction/compensation mechanism was also analyzed in a close relation to the financial resources of the EUB and it needs to keep the number of exceptions within sensible limits. The highest proportion of views expressed about reform show disappointment with the mechanism's lack of transparency.

Moreover, the summary of the conclusions of the public consultations regarding the financing resources of the EUB includes the relevance of opinions expressed with respect to the EUB's efficiency. Related to this, we should mention the diversity of opinions as to ways in which the community budget can become more efficient, with a general

desire to end the obsessive “juste retour” concept. The ways can be grouped in four directions:

(i) increased transparency, in particular through easy public access to information about the EUB;

(ii) a simplified structure, which involves the integration of all expenses in the budget;

(iii) strengthening the responsibility of member states, which would manage 80% of the resources distributed through the EUB;

(iv) a greater flexibility in the implementation of the EUB, so that it can react more quickly to challenges through expenditure.

## **Chapter II. COMMUNITY POLICIES AND THE EUB**

### **2.1. EUB – characteristics, content, development**

An important characteristic of the financing system of the EU's policies is autonomy; the European Union has its own budget, distinct from that of member states, thus differentiating itself from traditional international organizations.

Although the European Parliament, in the context of the co-decision making process, has been given relatively important budget competencies, these mainly relate to the expenses part of the EUB, such as the right to increase, reduce or redistribute the non-mandatory expenses (without having access to agricultural expenses), to adopt or reject the proposed budget and to vote the application of the budget by the European Commission (the annual management discharge). Thus, the Council of the European Union has lost its initial status of being the sole authority on the budget, but kept its right to have the last say on mandatory expenses.

The EU budgets have evolved from annual to a multi-annual (seven-years), and are prepared based on the Multiannual Financial Framework (MFF), which sets out the mid-term financial perspective of the EU. Thus the Union's policies are more effectively promoted, because annual budgets are interlinked as part of a longer term framework.

Although the MFF has not led to the complete replacement of annual budgets with multiannual ones, it considerably reduces the level of confrontation each year between member states on the level of expenditure and on what the money will be spent on. The MFF sets out the general limits of the annual budgets for the following seven years, the maximum ceiling, the rate of increase, as well as revenue and expenditure for each chapter.

The EUB is fundamentally different from the national budgets of the member states, as the national public institutions (the army, the police, the justice system, health and education) are the responsibility of member states and are financed from national budgets. The EU's institutions (the Commission, the Parliament, the Council, the Court of Justice) are financed by the EUB, but this expenditure is low compared with the responsibilities of a member state.

The problems in agreeing on a budget have generated extensive debate throughout the history of the EU. Some have argued that the EU

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should have greater powers to raise its own resources. There has also been considerable discussion about which of the European institutions should control the budget- Parliament, Commission or Council- and about the best means to solve imbalances. .

In the first years of the European Community's existence, the focus was on the consolidation of the European financial system, based on three main aims:

- a. unifying the budget instruments, as the integration process became deeper and wider
- b. increasing financial autonomy, to give the Community greater control of its own resources, and to widen its sources of revenue beyond income from the European Coal and Steel Community and contributions from the member states.
- c. obtaining an institutional balance in decision-making on the budget between the various European institutions. Currently authority over the budget is divided between the Parliament and the Council.

Important changes to the rules on the Community's budget and its financial system were implemented after the third wave of integration (the accession of Spain and Portugal in 1986) as well as after the adoption of the Single European Act, and the reform of the European budget and financial system, initiated by Commission President Jacques. Delors. The main changes were as follows:

- a way was established to set a total ceiling of own resources and contributions based on the GNI;
- annual financial planning was introduced, with a double limit on expenditure: limiting the payments from the annual budget, which cannot exceed the global ceiling as a percentage of the EU's GDP, and limiting each type of expenditure to a level set for each year;
- reforming the budgetary and financial system of the EU with the introduction of measures stipulated in the so called Delors Packages:
  - Delors Package 1 restricted expenditure on agriculture by limiting any increase to 74% of the average increase in GDP of the EU's member states. This package also doubled the allocations for structural funds; and created the fourth resource to finance new expenditure, based on the GNI of each country;
  - Delors Package 2, redistributed financial resources in favor of structural funds and created the cohesion fund.

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Creating the resources needed to offer financial support for the EU's expansion to the East was and still is a great challenge to the Community budget. To allocate resources to restructure the economies of new countries from Central and Eastern Europe without increasing the budget implies a reduction in resources for some of the less developed older member states such as Spain, Portugal, Greece, Ireland which are still carrying out their own processes of restructuring and modernizing their economies.

This is the reason why European finance specialists have been conservative with regard to the expansion of the Union towards Central and Eastern Europe, because they have realised how much more would be needed in structural funds.

It is obvious that, for Romania, the evolution of the financing resources system of the EUB until now had to adopt an effective strategy regarding the future reform of the budget. The present and future situation, which could include a new expansion of the EU, could limit Romania's access to Community resources, affect its net position by applying the principles of cohesion and solidarity, and lead to an increase in its national contribution.

In principle, Romania will suffer a reduction in EU funding if it does not increase its absorption rate. However, if the country does manage to achieve a better take-up rate of EU funds, the projects funded by them could generate resources in the medium and long term, which in turn will help Romania to raise its national contribution.

### **2.2. Principles, rules and procedures of the EUB**

Designing and implementing the EUB follows the principles and procedures of national budgets: unity, universality, having an annual cycle, balance and budgetary specialization.

1. the principle of annual budgets. The Community budget follows the classical principle of being annual, which means there is a connection between budget operations and an annual exercise, which helps the Commission to plan expenditure.

Certain activities of the EU are spread over many years, and so have needed to be included in several annual budgets. These projects have used dissociated credits, composed of engagement credits and payment credits. The engagement credits have the role of covering, in the financial exercise of the current year, the cost of some operations and actions whose accomplishment spreads over a period larger than one year. The payment credits are meant to cover expenditure needed to carry out the engagements

of the current year or of the previous year, and there is no requirement for supplementary budgetary authorization.

It is possible that, following the closure of the annual budget, the engagement credits could be higher than the payment credits, and the difference represents arrears engagements to be liquidated, a result of an imbalance in time between the point when contractual engagements are finalized and that when payments are completed, turning to the credit reporting system, which, in turn, needs special approvals.

2. The principle of unity. The community budget is an annual budget, which means that the totality of revenue and expenditure should be in a single budget document, to facilitate the tracking and control process of the use of resources.

Although the process of unifying the budget instruments has advanced, currently some structures of the EU have a special budget regime; as external and security policies, justice and internal affairs, European agencies or special funds and others. .

3. The principle of universality. This principle stipulates that all budget revenues represent a common mass that serves to finance all expenses, without discrimination. It is based on two rules: the rule of non-affect, which means that budget incomes are not affected by the will to make selected expenditure, specifically stated, and the rule of non-contraction, which means that decreases of revenues or expenditure are not accepted.

4. The principle of balance. The community budget must follow this principle even if it is not practiced at a member state level. This principle states that the revenues from one period must be equal to the expenditure of the same period, and it is prohibited to use a loan to cover a budget deficit.

The appearance, during the budget exercise, of differences between revenues and expenditure leads to either a budget surplus, which occurs frequently, and is carried over to the next year or a budget deficit, an exceptional situation, which requires a budget rectification which can only take place as a result of transfers from one post to another.

Because, usually, the EUB has surpluses, the expression negative reserve system is used. This involves a negative value being noted in the budget and disappearing over the course of the budget exercise through transfers from the chapters that will prove to have a surplus. This means that, when the budget for the next year is drafted, there will be funding for some expenditure by anticipating savings during the exercise, with no indication of what those chapters will be when the budget is voted.



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5. The principle of specialization. This stipulates that each credit will be put to a certain use and have a precise purpose, and the incomes will be tracked at source to identify possible failures and to prevent a deficit.

The requirements for the budgetary procedures are respected during the development, approval and usage of the budget, and this requires differentiated involvement of EU institutions. The European Parliament decides in relation to the so-called non-mandatory expenses, related to the functioning of the institutions, and the Council decides on the mandatory expenses, which relate to the commitments assumed through Community policies.

The decision making process on the budget by the Council and the Parliament has been undergoing continuous improvement, with a clear separation of the attributes of the two institutions. Legislative power remains with the Council, while power to decide the budget is divided between the Parliament and the Council, with the administration of the budget being carried out by the Commission.

### **2.3. EUB structure**

The EU budget is structured in sections, titles, chapters, articles and items. The most important part is the chapter, which indicates the budgetary authority's competency to authorize certain transfers from one chapter to another.

Funding is provided through the EUB OR, structured into three categories: TOR (customs duties, agricultural levies and others), Member States collecting these resources on behalf of the EU and withholding 10% for collection fees, VAT-based resources, plus their contribution to the rebate granted to Great Britain ("the British check"); GNI-based resources, their distribution assuming a calculation of the remainder which results by subtracting total expenses from total income accumulated in the first two categories of resources.

Achieving budgetary revenues involved two steps: by 1970. The budget was designed entirely on the basis of direct contributions from Member States. Then, the budget was funded by OR, which is revenue which Member States agree to pay to the EUB, as conventionally accepted community resources.

The Community's OR conventionally evolved from a structure represented by Customs duties on goods imported from outside the Community by applying the common customs tariff, levies on imports of agricultural produce and resources based on VAT, collected as a percentage

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of total VAT charged in each of the Member States (1% in 1979, 1.4% in 1986, 0.75% in 2002 and 0.5% in 2004), to the classification above, with the establishment of new ceilings.

There is a question to be raised at this moment. Is the current attempt to reform the EUB a response to the possible occurrence of a "crisis" in resources, due to the current recession or to other causes such as EU enlargement to 27 members or globalization?

It is possible that this approach prefigures the perception of a possible "crisis" at the level of the EUB's financial resources, but when considering the causes we have to consider the responses that common policies must offer to new political and economic challenges the EU faces and which were mentioned in the previous chapter.

Given this possibility, we believe that the current structure and resources of the EUB could change in the future and Romania should work to counter a possible expansion of the imbalance between contributions to the EUB and the funds raised from the EU, including by domestic efforts relating to the predictability of the regulatory fiscal framework and economic policies designed to stimulate a broader tax base.

Expenditure from the general budget is structured and ordered into six sections: European Parliament - I, Council of Europe - II, European Commission - III, Court of Justice - IV, Court of Auditors - V, the Economic and Social and Committee of the Regions - VI.

Payments made to Sections I, II, IV, V and VI are called running payments, i.e. of an administrative nature, (credit, expenses), while those in Section III, European Commission, are grouped into two categories: loans (payments, cost) of operation, which are meant to cover the European Commission staff, rents, materials, publications, computer systems, specific tasks, pensions of officials and others, as well as operational credits.

Operational credits managed by the European Commission have the following purposes:

- Funding agriculture through the European Agriculture Guidance and Guarantee Fund (EAGGF), Guarantee Section;
- Financing the structural activities: the European Regional Development Fund (ERDF), European Social Fund (ESF), EAGGF - Guidance Section, the Cohesion Fund, and the Financial Instrument for Fisheries Guidance (FIFG);
- Costs of education (Socrates), training (Leonardo), broadcasting (Media program), culture, communications, social relations, public health;
- Allocated to energy costs;
- Costs allocated to improve the functioning of the internal market;

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- Funding research and technological development programs;
- Financing costs related to various economic and financial cooperation measures with third party countries;
- Costs arising from foreign and security policy;
- Guarantees and reserves (Appropriations for the time of voting the budget) to be used during the year.

Although not the subject of this study, the expenditure side of the EUB is important for Romania as, through the funds provided by the EUB, it creates a nationwide basis to generate resources for Romania's future contributions to the Community budget, which may increase.

### **2.4. The EU budget and financial control**

Under Article 274 (205) of the Treaty, the European Commission is required to implement the provisions of the Community budget in accordance with the principles of "sound financial management." This is partially accomplished through internal financial control mechanisms of the Commission and European Court of Auditors, often in conjunction with national audit bodies.

The final stage of control is the procedure for closing a budget: once a year. On the recommendation of the Council of Europe, the European Parliament approves the closure of the budget and its the discharge to the Commission, which administers it.

Initial inspection of both revenue and expenditure is exercised in part by national authorities, as they keep the rights to their own resources and have the necessary apparatus to collect and control these amounts. 10% of OR due to the EUB are retained by the Member States as a collection fee.

At a Community level, control is exercised by executives responsible for audit and by accountants, while subsequent audits are carried out by the internal financial audit body within each EU institution. The role of the financial audit has been subject to an ongoing process of reassessment, which means that in the process of reforming the EUB it is possible that the Financial Regulations will impose a separation of audit and censorship functions from the approval process prior to expenditure.

External audit is exercised by the Court of Auditors, which, each year, presents detailed reports to the budgetary authority, including: attested accounting accuracy, legality and accuracy of transactions, an annual report on the implementation of the general budget, including budgets for all institutions and satellite bodies; as well as special reports on specific issues.

The role of the Court of Auditors is reflected in three major responsibilities, consisting of support for Parliament and the Council in exercising their function to audit the implementation of the budget, preparing the annual report after the close of each year, the report being submitted to the Community institutions and published in the Official Journal of the European Union, preparing the annual report on the regularity of accounting operations and the report on the regularity of the financial management of the budget.

The Court of Auditors carries out its obligations under the powers relating to the Community budget, which are as follows:

- Checking all accounts related to administrative expenses and revenues of the Community, including income from the tax set for the benefit of the Community on wages, allowances and bonuses of officials and its agents;
- Verifying the legality and regularity of income and expenditure referred to;
- Audit of revenue shall be based on the findings of the amounts owed and paid to the Community;
- Cost control shall be based on obligations and payments;
- Checks may be made before the end of financial year of the accounts in question.

The European Anti-fraud Office (OLAF) is formally independent of the General Secretary's Office of the European Commission. Set up at the initiative of the European Parliament, OLAF has an important role in protecting the financial interests of the Union with the responsibility to fight in all institutions against fraud involving EU funds and to coordinate similar bodies in Member States.

## **2.5. The evolution of the financial challenges of the EUB**

Since the 1980s, the rule that the overall EU budget is balanced and fully funded from the Own Resources (OR) ceased functioning, because over many years spending exceeded the estimated revenue. A first remedy to balance the EUB was switching to national contributions based on GNI resources.

The causes that triggered persistent budget deficits in the Community were: an increase of community agricultural costs, expansion of structural funds, a tendency for revenues from customs duty to fall, reduction in earnings on account of duty on imports of agricultural products,

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an increase in restrictions on agricultural exports, as well as reduction of income from VAT in Community member countries.

The relative reduction in revenues for the Community budget generated harmonization efforts between the level of resources and costs, and the Community institutions signed an inter-institutional agreement between the Parliament, the Council and the Commission, through which an agreement was reached on major budgetary priorities to be included in the financial perspectives of the EU.

Priorities have become indicators for determining the maximum size and structure of expenditure on seven main areas: agriculture, structural measures, internal policies, external actions, administrative expenses, reserves and pre-accession aid.

The Stability and Growth Pact (SGP - 2005) led to an increase in the credibility of the EU budgetary framework but identified some challenges, namely: the need to respect its spirit and encourage prudent management of fiscal policy even when the economic climate is favorable; a strong emphasis on the sustainability of public finances, improving the statistics of budgetary governance, increasing the synergy between budgetary policy and economic growth, as well as development of fiscal rules and institutions nationwide.

In the context of current debates on the EUB's OR, the Parliament adopted a resolution (March 29, 2007 - 2006/22005 INI)<sup>1</sup>, which summarizes the main shortcomings of the current funding system. The Resolution includes the following findings by the Parliament:

- Emphasizes that a system in which approximately 70% of the EU's income is not derived from the OR, but is resourced directly from national budgets through the GNI-based resource, while 15% derives from VAT, which cannot be considered an authentic Community own resource, as it strays from the provisions and spirit of the Treaty of Rome;

- Stresses that the EU's very existence has contributed to the intensification of intra-EU trade and the "welfare" in the Member States, which is why the EU is fully entitled to apply a system of Community own resources and not one fueled by genuine national contributions;

- Points out that this very notion of a "membership fee" has led to focus on the debate on the limited vision of the net taxpayer, who does not take into account the benefits of the EU in the area of peace, freedom,

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<sup>1</sup> Future European Union's own resources, European Parliament resolution of March 29, 2007 on the future European Union's own resources (2006/2205 INI), P6\_TA(2007)0098.

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prosperity and security in the Member States, despite the fact that the concept of 'net budgetary balances' has significant deficiencies from a technical point of view and allows only approximate evaluations;

- Stresses that neither the income part ("Rotterdam effect"), nor the spending part ("Luxembourg effect") of the net balances fully reflect the reality;

- Firmly believes that the current system of OR based on contributions from Member States is both unfair to citizens and undemocratic, and it does not contribute to strengthening the commitment to European integration;

- Indicates that the current system, as it is perceived as an additional burden on national budgets, cannot provide the Union with sufficient funds to achieve all of its policies;

- Criticizes the prerequisites created so that a country can officially fund only those policies which are in its national interest, which might negatively affect values that have characterized the Union's success over the past 50 years;

- Stresses that the current system, with its four different resources and different mechanisms of deductions, for one or another Member State, is too complex, lacks transparency and is difficult to understand for Europeans;

- Stresses that this system does not contribute to satisfying the need to establish a direct link between the Union and its citizens;

- Notes that, regarding the decisions on the MFF and the OR, the condition of unanimity is that any result of negotiations in these areas depends on the goodwill and financial possibilities of even the most reluctant Member States, whether rich or poor;

- Considers that this flawed system is the result of the weaknesses in the Agreement of the Council of Europe on the new MFF 2007-2013, concluded during the summit organized in Brussels on 14-15 December 2005;

- Believes that the financial package agreed, with its numerous exceptions on the revenue side and compensations granted to certain Member States on the expenditure side, is evidence of the inequalities the current system produces;

- Considers as unacceptable that all Member States have agreed on important projects of the Community, but will not then commit to financing them.

The presentation of these findings as a resolution of the Parliament is meant to inspire Romania's stance in the ongoing reform process of the

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EUB, even more as it reflects dangerous traps of the integration process *suis generis*.

### **2.6. Fiscal policy coordination and ensuring the sustainability of the Community budget resources**

#### *2.6.1. Coordination of economic policies in the EU*

Economic policy coordination within the EU includes the interaction between policy makers at a national level (Member States) and the supra-national level (European Commission and European Central Bank), the latter as representatives of Member States' shared interests, especially in budgetary and monetary matters.

The motivation for the coordination at an economic level is the attempt to increase the interdependence between the economies of member states, the proper functioning of the single internal market and the achievement of EU objectives.

Three basic principles to strengthen financial discipline at a national level within the EU are highlighted:

- The first principle to strengthen financial discipline is that adopted by the SGP based on strict rules laid down in EU treaties, which are applied by means of formal rules that bind member states. Otherwise, the penalty is 0.75% of GDP (the procedure is applicable only to the Member States of the euro area);

- The second foundation is rules-based guidance;

- A third one is based on the principle of voluntary coordination of economic policies of Member States, without implying the existence of a legal basis to do so.

The second basis underlies the development of the Guidelines for Economic Policy Measures, and involves the application of procedures as specified in the Community Treaties, without being enforceable in law.

The third fundamental principle implies the use of the open coordination method of economic policies, without being legally required to comply with rules and without allowing financial sanctions.

Under GSP, Member States are responsible for national budgetary policies. At the same time, it is mandatory to strengthen monitoring and to comply with budgetary positions, under the provisions of applicable regulations in the EU. Regulation on the strengthening of budgetary monitoring requires Member States to submit stability programs and Convergence Programs for states that are not in the euro area. The SGP also

states that Member States must be close to having a balanced budget or even have a budget surplus.

A second regulation stipulates an increase in the speed of the implementation of solutions to problems relating to excessive budget deficits, including by enforcing sanctions for Member States that cannot take the necessary steps to correct excessive deficits, and sets deadlines for their implementation.

Given the EU's common economic policies, it is necessary to have fiscal rules accepted and respected by all Member States, as part of the Community's institutional structure. These are desirable to be able to ensure the public finance policies, to prevent growth of public debt to unsustainable levels, to reduce uncertainty in government action, to facilitate long-term planning for key players in the economy, as well as to improve the quality of public finances.

Within the EU, fiscal-budgetary rules are essential not only to prevent the formation of excessive internal government deficits, but also to protect countries from adverse negative externalities and constraints. These rules at Community level may however limit the stabilizing function of fiscal – budgetary policy at a national level, as shown by the last financial crisis, in which some countries have argued for a greater flexibility in terms of budget deficits.

In terms of a better coordination of national economic policies, there are two desirable alternatives:

- Enhancing the role of the ACOR within the EUB, thereby increasing power in the fiscal – budgetary area of the EU, compared to that of Member States, or
- Development of a federal tax system with redistributive functions and waiving transfers at a national level.

Regarding a genuine EU tax policy at an EU level, we can only anticipate in theory the achievement of a type of fiscal federalism similar to the American one, which would imply a further loss of national sovereignty in tax matters, a big step toward political integration, but with the consequences of a reduced margin of maneuver for the Member States in the case of shocks of any kind.

Partial ending of national taxation policies by the concept of switching to authentic Community financial resources, will be accompanied by a more complex and efficient mechanism for spending EU funds, both to achieve common policies and for objectives of any kind with visibility in the national space of the Member States.



## ***The Future of the European Community's Resources and the Implications for Romania's Contribution to the EU Budget***

For now, as a conclusion, putting the EUB into operation is partly associated with a limitation of the competencies of national fiscal policies, but has led to a greater financial discipline, and built transfer mechanisms addressing the principles of solidarity and cohesion.

Under GSP, the tax and financial program of a Member State is governed by rules that provide a good management of the consequences of past decisions on: current and future public spending (consumption, investment, transfer payments, subsidies), structures and levels of tax revenue (rates, base, deductions and others), structure of transfers and subsidies, and government loans.

### *2.6.2. Fiscal policy - Community goals*

Through the stability and convergence projects which are developed and constantly updated, Member States are able to change their tax systems, and reforms in the field differ in scope and depth. Whatever the objectives to which they have to respond, Member States agree unanimously that fiscal policies must meet clear goals:

1. to enable all categories of businesses, as well as the population, to benefit from a single European market;
2. to pursue the objectives set by common policies financed by the EUB;
3. to be consistent with other EU policies, i.e. employment policy, environmental policy, competition, competitiveness and others.

For businesses and citizens to benefit from the EU single market, there is a consensus on principle on the inefficiency of the coexistence of different tax regimes. These inefficiencies have negative effects on the free circulation of goods, services, capital and labor and on competition as an engine for economic development.

Romania faces fiscal competition with some Member States, due to the existence of different tax regimes. It manifests itself as follows:

- Negatively, by distorting the free market; different taxation can subjectively alter companies' investment policy, if they have subsidiaries and branches in different EU countries;
- Positively, the population of states would take advantage of the fact that their governments provide public goods and services at low cost.

Community tax coordination remains effective within limits, as it fits in with two principles of European integration:

- Accepting the principle of fiscal policies of individual Member States, with certain conditions;

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- The principle of subsidiarity, namely vertical relations between European institutions and national governments.

To accelerate the coordination of fiscal policies, the EU is trying to use tools that remove pressure from states that have adopted tax reforms, thus being able to extend the impact of recommendations in the area and increase the efficiency of the extended cooperation mechanism which introduces sanctions for EU countries that do not cooperate.

Using these mechanisms, without the force of law, does not diminish the EU's effort to harmonize fiscal policies through mandatory regulation at least in certain matters of taxation, whereby the efficiency and functionality of the single market are not affected. In this respect, the Commission promotes the qualified majority rule of for decision-making processes, a rule that can benefit Romania usually, to the extent that national financial policy requires advance planning so that the appropriate amount is allocated for Romania's contribution to the EUB.

For Romania, options such as the modification of the financial mechanism in the meaning of "exporting" the tax burden, non-interference with the consequence of a fiscal "importer" state or using European mechanisms to change the domestic financial mechanism, while assuming unpredictable long-term effects should be analyzed in depth regarding the position assumed in the reform process of the EUB.

Recent monitoring has found, however, major concerns regarding the implementation of tax systems' interoperability with IT support, crucial for the proper functioning of the internal market, and urging the national tax administrations to take urgent steps to meet the requirements of interconnectivity, protection of intellectual property rights and fight against piracy and counterfeiting.

### *2.6.3. Some guidelines on fiscal policy in the EU*

Creating the single market called for changes to taxation, the removal of restrictions on capital mobility leading to fears that national tax bases could be reduced by its migration to Member States with more favorable tax regimes.

The effects of this migration can be seen in the distortions of the single market and tax competition between member states, affecting the degree of labor employment and the ability to ensure social protection.

Starting from the main objective of the Lisbon Strategy for the EU economy to become the most competitive and dynamic in the world, it is

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understandable that the overall reduction in taxation in the EU is part of that strategy.

This approach cannot leave out the compensation between the above-mentioned reduction and the need to support a process of fiscal consolidation, either by restructuring the tax system, or by reducing public debt, with the possible impairment of investment in essential public services.

As a result, the EU pursues a number of conceptual and practical objectives when it formulates its general taxation policy:

- A prime objective in the long run was the prevention of major differences between indirect tax rates and systems, which may distort competition within the single market through differentiated advantages enjoyed by consumers;

- with regard to direct taxation, the existing legal framework, which taxes at source, makes the necessary distinctions to avoid double taxation, through specific bilateral agreements between Member States;

- The concern to eliminate legal ambiguities is seen as a way of significantly reducing tax evasion;

- Preventing the negative effects of tax competition as a result of action by companies to move headquarters to another state in search of more favorable tax regime, concerns the Union in terms of limiting the volatility of national tax bases, although it is possible to invoke the benefit of limiting the excessive power of governments - through a high level of taxation - to tax and spend.

The Maastricht Treaty provisions on EMU give a new dimension to the general tax policy, strictly limiting the possibility of governments to finance public expenditure through borrowing. GSP states that Member States with a budget deficit exceeding 3% are to provide resources / deposit with no interest, which turn into fines if they fail to reduce the deficit. The overall aim is for Member States to keep budgets in balance over the economic cycle, which is why any increase in public expenditure must be financed by raising taxes.

Although these objectives have been generally accepted, national governments remain reluctant to take reasonable steps to harmonize their tax systems to a common denominator in the Community.

First, fiscal policy is seen as part of national sovereignty, and on the other hand, Member States' tax systems differ substantially, reflecting different economic and social structures and even conceptual principles on

the role of taxation in general and specific taxes in particular. Some examples are revealing:

- The general level of taxation and social contributions as a percentage of GDP, ranges from between 34% in Greece, and almost 55% in Sweden, the EU average being 42.5%;
- Direct taxes, consisting primarily of tax on personal income and the profits of companies, range from 9% of GDP in Greece, and over 32% in Denmark, the EU average being 13.7%;
- Indirect taxes, consisting primarily of VAT and excise duties, range from 11% of GDP in Spain, and over 19% in Denmark, the EU average being 13.8%;
- Social contributions range from 1.7% of GDP in Denmark to over 19% in France, the EU average being 15.1%.

In so far as the processes of globalization, climate change, the current financial crisis or other crises that may redirect future EU policies are concerned, we can state that increased powers at a Community level could include harmonization and transfer of more decision making on tax policy to the EU Institutions.

For Romania, the evolution towards a process of skills transfer on tax policy at Community level could lead to some policy changes such as:

- Finding, in the meantime, alternative solutions to meet the volume and composition of expenditure from the national budget, as some resources in its revenues, that become Community resources, are transferred. “Reserves” can be identified in this sense, but governments are tempted to draw on these to promote policies of economic development and government efficiency, especially in a time of an aging population and negative growth. Consequently, there is a need to:
  - Take action to curb or limit the speed of the process;
  - Intervene to make appropriate adjustments, harmonized with the tax skills transfer process.

## **Chapter III. IMPACT OF FUTURE EU BUDGET RESOURCES ON THE CONTRIBUTION OF ROMANIA**

### **3.1. Classification of expenditure as a strong motivation of EUB revenues**

For the period 2007 - 2013, with the adoption of the financial framework the European Commission has approved five chapters of budgetary expenditure, as follows<sup>2</sup>:

1. Sustainable development, which includes the following components:

1.1 Competitiveness for economic growth and the employment rate, which consists of expenditure on research - development, innovation, infrastructure, education and training;

1.2 Cohesion for growth and employment, including costs to improve convergence of less developed states and regions complementary to the EU strategy to support development at the expense of resources outside the less prosperous regions and inter-regional support.

2. Protection and management of natural resources, including expenditure on the Common Agricultural and Fisheries Policy and environmental costs;

3. Citizenship, freedom, security and justice, including expenditure on measures to support human rights and freedoms, justice, home affairs and citizenship;

4. EU as a global partner;

5. Administration and compensation. This chapter includes costs of administration fees directly related to operational costs, following logically from basic business management, the basis for annual budgeting. This chapter also includes costs for European institutions, other than the Commission, pensions and maintenance of schools at European level.

According to the principle of flexibility, over a period extending to 2013, there may be a possibility to adjust the principles of laying down spending limits:

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<sup>2</sup> Financing the European Union - Commission report on the operation of the own resources system, Brussels, July 14, 2004, the European Union general budget for 2009 the European Commission, Brussels, January 2009

a. Review Procedure of the expenditure ceilings remains the main tool that allows an adjustment of the financial framework if there are changes in political priorities. As a result of the rigidity in the application of this principle, there is a large variety of ad-hoc instruments with which to respond to changing priorities and urgent requests. Therefore, the Commission proposes an assessment of possible needs to the Parliament and the Council before submitting each preliminary draft budget;

b. The annual budgetary process should allow sufficient flexibility of the MFF to enable the Commission and the budgetary authority to respond immediately to emergency short-term crises or unexpected economic and political events. This would allow the budgetary authority to make appropriate reallocations within certain limits to the chapters of expenditure, except for cohesion and rural development for multi-annual programs;

c. The Commission has proposed and is provided, with the adoption of the MFF 2007 – 2013, with the possibility to activate the European Globalization Adjustment Fund to support workers made redundant as a result of major structural changes.

Implementing the objectives of the European Union, as reflected in the chapters of budget spending, require financial resources, as, indeed, is mentioned in the Treaty on European Union, Art. 311 (formerly Art. 269 in the European Economic Community Treaty) which states that "the Union shall provide the means to achieve its objectives and carry through its policies."

### **3.2. The current system of financial resources**

One of the main features of the EUB is its financial autonomy, as referred to in Art. 311 (formerly 269), which states that:

*“The budget is financed entirely from own resources, without prejudice to other revenue. The Council, acting in accordance with special legislative procedure and after consulting the European Parliament, will adopt a decision laying down the provisions applicable to the Union's own resources system. In this context it may establish new categories of own resources or abolish an existing category. This decision shall enter into force only after approval by Member States in accordance with their respective constitutional requirements”.*

Through the Lisbon Treaty, signed on December 13, 2007, provisions on MFF (see Chap. 2 "Multi-annual Financial Framework") were included for the first time in a treaty in the 27 Member States, which aimed at ensuring EU expenditure develops within its own resources.

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The MFF sets the values for the annual ceilings for commitments by category of expenditure and the annual ceiling on payment appropriations. Categories of expenditure, limited in number, correspond to large sectors of the Union.

### **Own Resources**

Almost all the specialist literature states that inter-governmental fiscal relations require the existence of a central government (as a supra-national body) which normally charges more contributions than it needs, leaving or transferring a portion of proceeds to national governments

As the EU is not seen as equivalent to a supra-national government, the concept of public finances at EU level is difficult to apply, at least because of problems that mainly characterize central governments, such as mediation of competition between national governments, which, normally should not exist.

An overall problem in the area of taxation at Community level is defining relations which should exist between national governments and supra-national institutions. The focus remains the ownership right, which may be national, even if taxes are collected at supra-national level, while the tax base and tax rates are also set at supra-national level.

Issues concerning the form of organization and functioning of the EU - as a Federation or Union - and the relationship between the EU institutional system and the national governments, is still far from being clarified. It creates distortions, both in the economic sphere, judiciary, and in the accounts.

One of the key features of sui-generis characterization of democracy in the EU is the principle of double representation. Representative democracy involves participation by Member States and their citizens in the legislative process, while in a federal model, citizen participation is the main source of legitimacy.

In practice, the double representation - as stipulated in Article 8A of the Treaty of Lisbon - is based on common legislative action of Parliament and the EU Council. This principle should be found and in the OR funding system, both through contributions from citizens, and by contributions from Member States.

The current system of EUB OR has existed since 1988. Although it has undergone various modifications, it has ultimately remained focused on the same four resources, namely<sup>3</sup>:

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<sup>3</sup> European Union general budget for 2009 the European Commission, Brussels, January 2009

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1. taxes on agricultural products entering the EU and sugar production tax paid by farmers in Europe, diminished over time due to reforms in the field;
2. customs duties on goods imported as referred to in the EU tariff system;
3. resources based on value added tax (VAT) collected in the Member States;
4. resources based on gross national income (GNI), representing a proportion of GNI of the Member States.

Dissatisfaction when coupling these OR in some Member States led Great Britain to negotiate rebates and discounts to be granted on crude GNI-based resource for the Netherlands and Sweden.

The first two resources are known as "traditional own resources (TOR).

### *Brief History of OR*

*The OR financial system was first adopted when establishing the European Coal and Steel Community (ECS) and thus creating a need to fund its operation. The government revenues are provided by an established direct tax on natural resources (i.e. those that contribute to steel production).*

*To ensure the financial resources of the EUB, the idea of its funding through intergovernmental contributions was first adopted, excluding direct taxes. Fully funding the EUB on behalf of Member States' contributions was clearly stated even by the Treaty of Rome. This method of financing was used until 1970, when, by Council Decision, fundamental changes for the respective resources were introduced.*

*To implement and support the GSP, in 1971, the concept of "own resources" to finance the Community budget was adopted, and the community's budget received revenues from:*

1. taxes on agricultural products and sugar production (introduced in 1971);
2. duties, phased in between 1971-1975;
3. VAT-based resource (fully implemented in 1979).

In 1984, the three resource structure was adjusted following the adoption by the Council of the UK rebate mechanism, manifested in a reduction applied to the financial contribution of Britain, which gained less from GSP.

In 1988 the Council introduced the fourth resource to fund the EUB, that based on the GNI of the Member States to balance the EUB, as a consequence of the need for new financial resources to support increasing costs of EU policy implementation.



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Introducing the contribution of Member States to the EUB in accordance with the GNI, as the fourth financial resource of the EUB, has attracted a greater involvement of member governments to finance expenditure in the EU on the one hand, but on the other hand, had the effect of reducing the EU's financial autonomy.

This was the point when Member States gained the opportunity to more thoroughly evaluate their contributions to the national EUB, thus generating the concept of "juste retour" and especially the debate on the concept of "net contribution" and position the *large net contributor* to the EUB.

Regarding the evolution of the OR's share in the EUB's total financial resources, since 1988, there has been a reduction of resources based on VAT, alongside an increase in contributions from Member States based on their GNI<sup>4</sup>. This trend was maintained over a period of approx. two decades, but it has had some drawbacks consisting of:

1. gradually reducing the financial autonomy of the EU;
2. the excessive increase of control over the use of EUB resource funding by Member States;
3. persistence of Member States to obtain the highest possible return of as much of their contributions as possible for their benefit;
4. a decrease in interest from member states in the adoption, implementation and achievement of Community large scale objectives;
5. reducing the role of Community wider structures in the functions for which they were created, related to the implementation of the EUB.

Suggestions have been made that there should be a permanent reduction in the proportion of VAT based resources within the OR, or even its total elimination, due to difficulties of calculation and collection cost.

Although increased weight and importance of national contributions, based on GNI resource in the EUB, has been the subject of many criticisms, it seems that it will remain the preferred resource for many Member States to finance the EUB.

### **3.3. Efficiency of decision-making at EU level in relation to EUB income**

Efficiency in the financing of the budget should be understood in two senses: first, in terms of distortions in the incentives to the private sector, and the decisions to be taken and, secondly, in terms of effectiveness of rules and procedures for making decisions in the public sector.

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<sup>4</sup> Financing the EU budget, study for the European Commission, April 29, 2008

In the first case, , it can be argued that the resource of the contribution of Member States based on GNI is a source that generates more distortion in the private sector than genuine own resources collected uniformly for all taxpayers across the EU. The reason is simple; different national economic structures mean that the financial burden, even if a percentage of GNI, cannot be distributed to national tax systems on all taxpayers. Therefore Member States will be obliged to adopt exceptions to the "Level Playing Field" rule which is mainly recommended for EU policies as applicable to a single market in terms of competition policy<sup>5</sup>.

As for making decisions in the public sector, efficiency should be understood not so much through the prism of the concept of cost - benefit from the administrative point of view, but rather through the whole process of the decision-making capacity to meet citizens' preferences.

Thus, the effects of the current financing scheme of the EUB cannot be regarded as the best, if taking into account significant dissatisfaction, , expressed in the Council, Commission and Parliament, on the one hand, and critical comments of many analysts on the results of negotiations on the MFF for 2007-2013, on the other.

The main problem appears to be correlating decisions on costs and financing these at the expense of national payments. National administrations should be able to pay national contributions under alternative schemes based on authentic OR, but the biggest debate focuses on conditions for the distribution of the tax burden by category of taxpayers and the amount of the most appropriate OR in terms of political responsibility related to criteria distribution distributed in national budgets.

Establishing stable, reliable and efficient OR, even as ACOR, allowing greater predictability of future financial resources of the EUB and their correlation with the costs of Community objectives, necessitates in principle decision making by consensus between Member States to help improve the current system of financing the EUB's resources. These decisions must include giving greater powers to the European Parliament in budgetary matters.

### **3.4. National contributions and their interpretation**

Allocating resources vertically, from bottom to top, to finance the EUB is a useful way of highlighting the amounts to be transferred and is

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<sup>5</sup> Financing of the European Union Budget – Study for European Commission, Directorate General for Budget, Final Report, 29th April 2009

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likely to determine, both members of national governments, civil servants and members of national parliaments to accept them as expenditure for the national budget.

Although this could be seen as a welcome feature for the national authorities to exercise control over the use of domestic taxpayers' money at a supranational level, in practice, this does not happen because the MFF procedure, once adopted, states that national contributions are calculated automatically without being subject to the control of national parliaments.

A concern regarding the GNI-based contribution of Member States is that it would not be an ideal measure of the capacity of Member States to pay. Failure to apply the principle of taxation that each contributor has to pay according to its ability to pay leads to automatic obligation for the states to comply with the Accrual Based Accounting System (ABAS) and International Accounting Standards in the Public Sector (IASPS). Collecting the contribution of GNI, and checking amounts that are attributed to each country as payment obligations, are closely monitored by the GNI Committee, the technical body of the Commission (like the VAT Committee).

GNI-based contribution raises issues regarding the methodology of calculation of this indicator. The main problem is its different structure from one state to another, reflecting differences in living standards. Certain elements, such as the revenues of financial intermediaries, are omitted when determining the level of the GNI contribution base, even if this revenue could represent about two percentage points of the GNI of certain Member States<sup>6</sup>.

One of the measures that could be taken at EU level could be that, based on a contribution of Member States on behalf of HLG, even when differences in living standards exist, a uniform methodology for setting of GNI could be adopted.

### **3.5. Payment mechanism**

Studies by analysts<sup>7</sup> have pointed out that the payment mechanism works very well and presents no problems.

Presently, there are two sequences of monthly payments by Member States, through which the amounts due are collected; first, the VAT-based

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<sup>6</sup> Funding the European Union, Report with Evidence, House of Lords, March 2007

<sup>7</sup> Financing of the European Union Budget – Study for European Commission, Directorate General for Budget, Final Report, 29th April 2009

resource, the contribution of Member States on account of the resource based on GNI, (less the rebate payable to Britain, and the gross reduction of GNI resource for the Netherlands and Sweden) and, secondly, revenues collected from TOR by the Member States' customs administrations.

The amounts to be paid by each Member State are determined in annual budgets that are negotiated by the budgetary authority. Once they have been approved, they become mandatory contributions of Member States to the EUB. It must be said that only amounts due under the VAT and GNI, after negotiation and acceptance, become binding, whereas TOR are paid on the amount actually collected, less 25% of the gross amount collected by way of administrative expenses.

The Commission has the right to require up to 5 / 12 of the amount due to the formation of VAT and GNI-based resources and the corrections to be paid in the first quarter in order to ensure funding of specific expenditure for the SGP.

If cost savings occur during a budget year, the Commission will make adjustments to the budget that will be reflected in pay cuts based on GNI for the remainder of the year and will carry forward the saving into the next budget year.

From the point of view of ensuring cash inflows to finance EUB expenditure, the current mechanism of payments may be considered appropriate, both as a means of implementation and for the administration of payments by Member States, and receipts from the EUB.

### **3.6. EUB resources - implications for future**

Prospects for the EUB's financial resources should take account the critical analysis and recommendations released in consultation with national authorities of Member States, which had to complete a questionnaire. The Commission's recommendation is to note that the answers to questions should not be provided by politicians but by experts in public finance.

After processing the answers to the questionnaire four scenarios were developed, two for each relevant time horizon following the period covered by the MFF (assumed to be 2013 and 2020), and a fifth, without a time frame, called "taxation by representation," corresponding to the time that could be the final step toward financial autonomy of the EU budget<sup>8</sup>.

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<sup>8</sup> Financing of the European Union Budget – Study for European Commission, Directorate General for Budget, Final Report, 29th April 2009

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These scenarios not only anticipated funding resources and their possible development, but also a part of a systemic approach, the possible combinations between the four scenarios. While some of the proposed OR could easily be introduced without changes to the Treaty, as have been accepted so far, others will require changes to it. Although this should not be overlooked, as it can be a serious obstacle to reform proposals of the EUB, we must remember that in the last two decades, there have been quite frequent changes to the Treaty.

Presentation of the summary of the five scenarios, to which we shall return in a next chapter, reveals the following:

1. Minimum reform in 2013, which implies a simplification of VAT as a resource, while other financial resources would remain unchanged;
2. Own resources of the Community in 2013, which requires the introduction of new financial resources to ensure at least 25% of the total financial resources of the EUB;
3. Minimum 2020 reform, which involves maintaining national contributions as the main financial resource, with gradual introduction of equalization on the revenue side of the EUB, using progressive contributions due from Member States;
4. Community's own resources in 2020, involving the establishment of new TOR that would provide 10% of its funding, and at least 40% of total resources to be provided by these new resources;
5. Taxation with representation.

We consider that scenarios 1 and 3 would require a "minimum reforms", and the dominant criteria are "administrative" - reliability, stability, simplicity of administration and lower costs for collection, with a strong emphasis on "fairness" between Member States, involving minor changes in the current funding scheme. This approach would be appropriate with criteria such as reliability and stability of income, which are more important than others underlying the financial resources.

Scenarios 2, 4 and 5 put a great emphasis on the creation of Authentic Community own resources, (ACOR) based on a different set of criteria, namely those that promote efficiency and convergence with the EU, while the above criteria are omitted.

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Regarding the prospects for the future, answers to the questionnaire distributed during the public consultation process in the Union, reveal the following conclusions<sup>9</sup>:

a. It can be argued that the combination of resource revenues with EU policies (such as trade, the single market, monetary integration and the potential transboundary environmental initiatives) should be increased;

b. The vast majority of Member States participating in the survey expressed a general agreement in connection with maintaining the current system of OR, with the exception of the resource based on VAT;

c. current OR meet the criteria of stability and confidence, while the criteria of simplicity and visibility, are less well respected, and so require review;

d. The criteria of stability and confidence were considered, at the same time, by the Member States participating in the survey as the most important criteria for assessing the EUB's resources;

e. Regulation of a strictly balanced budget was regarded as suitable for the EUB;

f. A generally positive attitude was taken to the existing institutional context and the procedure for adopting the MFF;

g. Assessments of the TOR;

h. Viewpoint on VAT resources which were generally negative;

i. The views on the resources based on GNI were very positive;

j. GNI-based resources were assessed as suitable to be used for residual or balancing the EUB;

k. Various groups of Member States had divergent views about whether or not current mechanisms for correction should be used for budgetary imbalances arising from national contributions to the EUB, or if these should be used only to cover temporary spending overruns of the EUB;

l. In contrast to expenditure on GSP, that relating to cohesion policy was regarded as a form of fiscal equalization in the Member States.

Three issues were raised with respect to the contribution based on GNI, of which the first two reflect a profound ambiguity about the EU's position, such as:

1. The autonomy of the EU, the budgetary authority;

2. Visibility of the OR and implications for transparency and legitimacy;

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<sup>9</sup> Financing of the European Union Budget – Study for European Commission, Directorate General for Budget, Final Report, 29th April 2009

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3. Procedural and implementation problems, including determination of GNI.

### **3.7. One possible reform of own resources**

To select new OR financing for a reformed EUB, European Commission studies indicate a number of criteria that should be considered as a basis for examining and determining the EUB's resources.<sup>10</sup>

These criteria are:

1. Visibility and simplicity;
2. Financial autonomy;
3. Increased efficiency in resource allocation;
4. Credibility;
5. Administrative efficiency;
6. Stability of income;
7. Equity in the contribution.

In choosing a new OR it could be tempting to consider only the criterion of simplicity, empowerment and the gradual increase of the power of decision-making bodies at EU level to collect revenue directly to the EU budget without relying exclusively on national contributions. However, choosing a combination of OR (duty or non-tax) as a major source of financing the EUB would probably be a better option, because each tool can generate inter-state distributive consequences that may be - if well chosen - mitigated by others. In addition, a combination of funding sources would also help achieve the goal of a balanced budget. .

Even so, a correction or balancing mechanism is required to achieve the collective objectives and specific requirements of national distribution, whatever they may be. Assuming that sufficient reform will be implemented on the expenditure side, so that distribution issues are assigned revenue, introducing new sources of income should be supplemented by an automatic scheme based on a formula of tax equalization.

#### *3.7.1. Correction mechanisms and equalization*

A simple version of such a mechanism could be a progressive system in which richer Member States are charged a higher rate and the

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<sup>10</sup> Financing the European Union-Commission report on the operation of the own resources system, Brussels, 14.7.2004; Own Resources- Evolution of the system in a EU of 25, Study for the European Parliament, 30 June 2005; Taxation Papers – ax-based EU own resources, An assessment, Working paper No 1/2004.

poorer ones a lower rate, with the thresholds established by a simple indicator such as GNI per capita.

However, such variation could lead to friction where a Member State's GNI is close to a threshold. Being just above or just below the threshold, which is equivalent to relative wealth or poverty, leads to the need for differentiation formulas.

A general mechanism for integration of corrections and equalization could be inspired by an equalization approach on the revenue side. Member States which receive a low threshold of expenditure would benefit from lower contributions, but those with a low level of income would be in the same situation. The question is therefore what kind of formula would be appropriate to calibrate national financial contributions to the EUB.

The effect of such correction and equalization schemes is that the poorer Member States pay relatively little per capita (per capita equalization mechanism), in cash, to the Community budget, although the percentage of GNI would be greater. Meanwhile, relatively rich Member States, receiving corrections on the revenue side, also pay less in terms of cash, with a small percentage of GNI, while the group of Member States situated between the two extremes - poor and rich - have the largest contributions in terms of cash in financing the Community budget.

Each fiscal equalization system has different components that can be distinguished conceptually. The first distinction is between horizontal and vertical patterns. The horizontal approach is to redistribute money from rich to the poor regions, while the vertical approach means that money is distributed from the highest level of tax to the poor regions. In practice, the two types are particularly difficult, since each vertical transfer is financed, in fact, by the rich regions, and most federations use a combination of two types.

In ideal form, the system sets the transfer to each sub-national administration in order to match the difference between income per capita in a given tax and average income per capita of the same charge in the federation. Obviously, this system could only work if there is a degree of harmonization of taxes in the region, otherwise the risk would be to take as a basis the lowest level of income.

However, it should be noted that the horizontal or vertical compensatory transfers supplement other equalization functions implemented by central government, such as collecting taxes to finance public goods (equalization function derived from the contributions deducted for low-income areas to finance a public good, such as defence policy), unemployment benefits and other welfare.



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Introducing a generalized correction mechanism, presented in the following chapter, with transparent rules and thresholds may be preferable because it would have at least the appearance of greater objectivity. However the introduction of any mechanism for correction - generalized or not - may be unattractive because it would raise questions from the Member States relating to allowances received by the EUB as unfair, either in terms of value or benefit.

### *3.7.2. Generalized correction mechanism*

In principle, if there are corrections as part of a new systemic approach to EUB revenues, then they should be generated on more than an ad-hoc basis, although it can be argued that one of the possible benefits of ad-hoc arrangements is that they may be easier to remove.

In 2004, the Commission proposed introducing a general correction mechanism with the following provisions:

- Each Member State would be entitled to a reduction in its contribution to the EUB;
- Eligibility for a reduction would be activated when the contribution has reached a threshold of 0.35% of GNI;
- The rate of reimbursement would be in the form of a reduction of 66% of the net (the same percentage as the rebate for Britain);
- Maximum available reimbursement's absolute value is 7.5 billion euro per year.

The advantage of this mechanism would be that it would apply equal treatment to all States which contribute excessive net to the EUB. The complexity of the current system, which requires "rebate to rebate", could be simplified by the payment of only partial compensation and fixing an overall boundary correction for correction costs.

At the same time, the "weaknesses" of the current mechanism should not be omitted, just because they distinguish between the funds allocated for convergence - which redistributes money from rich to poor countries, which is politically accepted - and the distributive effects of the GSP, which are not usually related to relative wealth. Also, there is no guarantee that the introduction of higher performance will determine Member States not to seek or obtain additional individual corrections.

*3.7.3. Evaluation of a possible reform of the financial resources system*

Evaluation of a possible reform in the financial resources of the EUB can be achieved at the expense of all the answers to the questionnaire launched at EU level, out of which the following main conclusions resulted<sup>11</sup>:

a. Overall support for sovereignty and fiscal neutrality, reform-related expenses and eliminating correction mechanisms as key principles which should result in the possible reform of the OR system, both medium and long term. There are Member States ready to cede that part of their fiscal sovereignty to the EU. Many member states are also in favour of fiscal neutrality, meaning that reforming the EUB resources should not increase the tax burden on the EU's citizens;

b. Equity, horizontally and vertically, among all Member States, confidence, stability, simplicity and effectiveness of resources were identified as the most important, specific criteria that should result from a possible reform of the OR;

c. The preferred option for reform of own resources, both in the mid and long term is one that combines TOR with GNI-based resources. The idea of maintaining the system resources unchanged (the four existing resources which finance the EUB) was fundamentally rejected. Moreover, the proposal for a system based solely on community fiscal resources (single or multiple) but with no resource for balancing the budget, implying the existence of a deficit or surplus budget was also rejected;

d. Participants in the survey were generally in favour of the introduction of ACOR-based taxes, i.e. taxes at European Union level;

e. If a tax were to be introduced at EU level, then VAT, excise duties on motor fuel and excise duties on tobacco products and alcohol are considered as the most suitable. Since these taxes best meet the seven criteria above for a fiscal resource, these and the methodology for calculating them would represent the new element of reform of OR in the EUB. Modulated VAT is gaining support as a potential financing source due to the high level of harmonization of Member States' application of Directive 112 / 2006. There is also significant support for motor fuel excise duties because of its stability as a resource for the EUB;

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<sup>11</sup> Financing of the European Union Budget – Study for European Commission, Directorate General for Budget, Final Report, 29th April 2009

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f. In general, participants in the survey did not agree with the idea of non-fiscal financial source revenues in the EUB. Approximately 80% of survey participants expressed reservations about the use of user charges and also green-house gas emissions as possible Community sources of financing ACOR to the EUB. Meanwhile, the same participants were in favour of using the monetary income of the European Central Bank (ECB) as a financing source, although this presents the problem of the need to find a substitute for Member States that have not adopted the single currency;

g. If a genuine non-fiscal Community resource were to be permitted, then the ECB's monetary income would qualify. To be considered a potential financial resource for the EUB, revenues would have to meet the seven criteria above, and in the case of the ECB's monetary income these are met;

h. Assuming that the removal of all the mechanisms for correction of budgetary imbalances would be impossible, the survey participants expressed cautious support for the introduction of a generalized correction mechanism. About 70% of survey participants believed that an important objective of the EU budget reform would be to eliminate all mechanisms for correction of budgetary imbalances;

i. Participants in the survey were against alternative approaches to excessive budgetary imbalances. 90% of those surveyed did not support any mechanism for equalizing the income of the EUB, arguing that the OR system should be simple and transparent, requirements that might be compromised by the introduction of such an equalization mechanism. An idea was launched that all the equalization mechanisms should be applicable on the expenditure side of the EUB.

### **3.8. Possible scenarios for achieving reform of the financial resources of the EUB**

The five possible scenarios for reform of the EUB's financial resources<sup>12</sup> reflect a gradual and differentiated approach to reform. Starting with a minimal reform of the system's resources, along with a restructuring of their importance in the existing system, to gradually reach an extensive reform, leading to extensive growth in the proportion of OR within the budget, in parallel with the eventual replacement of the national contributions by Member States.

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<sup>12</sup> Financing of the European Union Budget – Study for European Commission, Directorate General for Budget, Final Report, 29th April 2009

The fifth scenario involves a radical reform of resource system, called "taxation by representation", and implying a politicized system of own resources, under which the European Parliament would become a central tax regulating organisation.

### **1. Minimum Reform 2013**

The basic principle for this scenario is that funding will continue to be mainly based on national contributions, but including TOR.

Simplification is seen as an attractive principle; especially if it could lead to reducing the administrative costs of collection associated with a more efficiently financed EUB. At the same time, simplification could facilitate public understanding of the EUB's operation, an important principle for the MFF.

The principle of payment of contributions based on GNI of the Member States has broad support and should continue, as a principle.

### **Reasons why GNI-based contribution to the EUB resource funding should be kept**

The advantages of continuing to use the GNI-based contributions include:

1. they ensure a continuous and stable flow of resources to the EUB;
2. the residual nature of the contribution, having a role in sizing costs; the higher the approved expenses, the more Member States will need to increase resources to finance the expenditure;
3. although the amount of contributions by Member States is not always visible to the taxpayers of those states, it can be argued that the resource, calculated as a share of GNI, may be regarded as transparent;
4. in terms of cash flow, a steady and continuous contribution is transferred to the Commission for purposes of administration. The amounts due are easily calculated and the required monthly payment is known by the Member States;
5. the resource has a definite legal basis - Decision on the OR - which is reviewed with the MFF. Although the contribution based on GNI is rather an intergovernmental transfer than a tax itself, as understood in the literature, in strictly legal terms it meets the requirement of the Treaty that the budget should be financed by OR.

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### **Reasons for GNI-based contribution to the EUB resource funding would be replaced**

Severe criticism of the use of GNI-based contributions reveals reasons why this financial resource of the EUB should be replaced, but not before questions raised by supporters of maintaining the contribution are dealt with:

a. why should it be replaced when this resource is supported by governments and national administrations as it ensures stable and secure financial resources for the EUB and the collection mechanism is very simple?

b. why do the European Commission and European Parliament consider that the current financing scheme is an obstacle to achieving better decision making on the implementation of the EUB?

Based on these questions, the reasons against the use of GNI-based contributions to finance the EUB's resources are based on two separate arguments:

1. efficiency of decision making in the European Union;
2. notions of "net national contributions" and "horizontal equity".

In this presentation of the reasons for and against, it can be inferred that the scenario "Minimum reform 2013" would involve little change of the current system of financing the EU budget. But first it must be seen what does not change:

- The ceiling of own resources;
- Provisions of the balanced budget;
- Use of GNI, as currently measured, as a statistical indicator for national contributions and maintaining proportionality of gross contributions, pre-correction;
- Assigning values from traditional own resources to the EUB;
- Resources based on GNI, as the main funding mechanism;
- The residual character of the resource based on GNI;
- Payment methods of the Member States.

Reflecting the growing consensus that the VAT-based resource has become, de facto, the second resource after that based on GNI, the only significant change in the OR would be its abolition as a separate resource. On the one hand, this change would be consistent with the simplification of the administrative work of the Member States and could be presented as a way to ease the explanation for the funding of the EUB, and on the other hand, would have only a marginal impact on the distribution of gross

payments between the States and would facilitate the making of gross payments proportionate to HLG.

Given the expected growing number of net contributors past 2013 and a consolidation of resources based on VAT and GNI in this scenario, some changes will be needed in the existing arrangements. To manage these events, a generalization of correction mechanisms based on a threshold for net contributions would be a possible solution.

Finally, Scenario 1 involves the use of financial resources only as TOR and GNI-based contributions, whereas the VAT-based resource could be abolished. Note that this scenario implies the generalization of widespread correction mechanisms that are based on contribution ceilings of the Member States. The advantage of this scenario lies in the significant reduction in labour management of the Member States relating to resource management based on VAT.

## **2. Community own resources 2013**

This scenario requires the introduction of new resources to provide at least 25% of the financial resources for the EUB. Resources that could be considered should not require changes to the Treaty<sup>13</sup>, which would generate great disputes between member states.

In contrast with the scenario minimum reform 2013, the scenario Community's own resources 2013 would involve Member States already deciding - for MFF below - to allocate "real" OR to the EUB, but keeping, at the same time, the majority of other aspects of the budget in the initial state. Since the introduction of a tax at the Union level would cause political debates for the immediate post-2013 period, this scenario would provide the introduction of an instrument for non-tax revenue, that would not require changes to the Treaty, although one option might be to introduce such a tax.

The essential principle for the scenario: "Community's own resources 2013" is that funding should not be based exclusively on national contributions, keeping TOR, but a first move should be made towards obtaining ACOR for the Community budget.

The scenario "Community's own resources 2013" is similar to the minimum reforms in 2013 in all respects, except for the sources. In this scenario, the EUB would have three sources of funding:

- TOR keeps the same characteristics as in the scenario "minimum reform 2013." Taking into account the main characteristics of these sources

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<sup>13</sup> Treaty on European Union and the Treaty establishing the European Union

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of funding, it is assumed that their share in the total financial resources of the EUB will decline.

- New non-tax-tools would contribute on average 25% of total revenues to the EUB. In terms of dynamics, the rate of this source of funding is expected to increase. The scenario includes taxes on flights and / or sale of licenses for greenhouse emissions as possible sources of funding.

- The GNI-based resource is preserved as in the scenario "minimum reform 2013," but with the amendment that this scenario introduces progressively into account the contribution of this resource, as a way to achieve distributive goals on the expenditure side.

- A variation of this scenario, which would not significantly alter the principles, but would involve more extensive changes and may be feasible only in the long term, such as 2020, would be to set more ambitious targets for the ACOR taking its share, up to 50%. As explained in detail in the fourth scenario (and as was noted in the report of the European Commission for OR), a justification for a higher share of ACOR is the dual nature of the EU as a union of citizens and Member States. The key difference between this option and scenario 4 is that it would not involve changes to the Treaty.

In conclusion, the scenario Own Resources Reform 2013 "implies the use of the financial resources of the TOR, of financial resources based on non-EU tax, which would represent, on average, 25% and with forecast growth of up to 50%, of total EUB revenue, as well as the contribution based on GNI, which would be paid on the basis of a progressive system. Potential non-tax-based resources could be taxes on flights and / or sale of certificates of greenhouse emissions.

### **3. Minimum Reform 2020**

This scenario involves maintaining national contributions as the main funding resource for the EUB, but gradually introducing equalization on the revenue side. Equalization would be made by using progressive gross contributions, but how such a mechanism might work is not explained.

The dominant criteria for income instruments underlying this scenario are stability and sufficiency. Under this scenario, it is assumed that progress will have been made for EUB spending by adopting corrections to compensate for budgetary imbalances with no motivation. However, there would be an essential difference on the expenditure side, if the reforms would have advanced sufficiently for a consensus to have been reached on a guaranteed package of spending. In these circumstances, "juste retour" loses its relevance as a basic principle.

Instead of a more subtle approach to determining the "ability to pay" as the underlying principle for revenue collection, this approach would require more effort for a transition to payments based on a progressive system, replacing proportionate payments. The reason for this change is acceptance of progressiveness as a typical attribute of the tax system, which would help the system to reduce the emphasis on the concept of "juste retour", legitimating the equalizing element.

A second scenario is the basic principle of mitigation, to eliminate, corrections, assuming that their invocation is always something unusual.

Scenario "minimum Reform 2020" does not involve changes in:

- OR-ceiling (or at most only a minor increase);
- Balanced-budget provision;
- GNI-use as currently measured, as a statistical indicator for national contributions;
- TOR-allocation values of the EUB;
- GNI-based resources as the main financing mechanism;
- Residual nature of the resource-based GNI;
- Terms of payment of Member States.

In contrast to the scenario "Minimum reform 2013," the "Minimum reform 2020" scenario involves passing to a progressive system for gross contributions to the budget, either by implementing a series of limits (thresholds) for gross contributions of GNI-based resources - perhaps the full rate 0.8, 1 and 1.2 - or by implementing a mechanism / program slow progression, reflecting the increasing dynamics of GNI per capita, by setting upper and lower limits.

#### **4. Community own resources in 2020**

This scenario establishes new resources assuming that TOR would provide only 10% of its funding, and at least 40% of the total should be provided by new resources. Regarding the share of TOR, we note the existence of different opinions concerning their nature (tax or non-tax).

In strictly legal terms, the option for new resources would not be likely to generate changes in the Treaty, in particular the Lisbon Treaty, given the expanded role awarded to Parliament in the budgetary procedure. This scenario requires that income arising from the Union's common policies, such as proceeds from auctions of tradable emission permits or the monetary revenue of the ECB become ACOR; they will replace other conventional tax-based resources.

Although the history of European integration has been dominated by gradual changes rather than large institutional jumps, the possibility of a



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major restructuring of the financial resources of the EUB in the next 12 years should not be excluded ex-ante.

The Community's own resources 2020 scenario contains the major elements in support of the entire alignment of the EUB to this state of political integration. They would generate a budget type considered ideal for the sui-generis system of developing the Union for this stage, combining the contributions of Member States with direct taxes and non-tax revenues with authentic Community character.

One of the provisions that distinguish certain versions of scenario 4 from the previous three scenarios is the need to amend EU treaties. It follows the same principle of double representation of representative democracy by involving in parallel Member States and citizens in the legislative process. In the present EU, the dual representation - as stipulated in Article 8A of the Treaty of Lisbon - is based on common legislative action by Parliament and the Council.

To reflect this dual representation, the EU budget in 2020 should receive 50% of its funding from taxpayers (through the Community OR) and 50% from payments by Member States. A more aggressive EU funding through a contribution based on taxes imposed on EU citizens, covering 100% of the EUB's revenue, would not correspond with the current state of the European integration process.

Scenario 4 is based on the following principles:

1. Funding would be divided equally between the national contributions and ACOR. According to the dual nature of funding the EUB, the European Parliament should gain the right to legislate in the selection and imposition of authentic Community taxes.

The objective of such accreditation to the European Parliament could be that the ACOR would provide half of the financial resources of the EUB. At the same time, we believe that the problem of scenario 4 is not an exact division between national contributions and ACOR, but whether this balance effectively reflects the dual nature of democratic representation in the Union.

Variations of this scenario could therefore involve an increased contribution of direct taxes from EU citizens, but with effects on the power of Parliament. If the right to impose taxes should remain based on co-decision making, thus involving the Council, then the last word in this case should belong to the European Parliament. This fundamental change in the architecture of the EU decision making process would ensure the European

Parliament the position as the first source of direct democratic representation in the European context.

2. Member States' contributions to the EU budget would be progressive, reflecting the relative prosperity of Member States. The EUB should contain those types of non-tax revenues derived directly from the EU's exclusive competence. The division of responsibilities between the EU and Member States would also allocate accordingly, the revenues of:

- Trade and GSP (TOR);
- The ECB's monetary income.

If by 2020 other powers or responsibilities of Member States were transferred to the EU, in whole or in part, any income generated by such transfers would be allocated directly to the EUB.

3. In terms of the ECB's monetary income, it would be necessary to amend the treaty to bring the present relationship between the national central banks and the ECB into a new framework. Transferring ECB monetary income to the EUB does not involve risks of independence and will preserve the financial autonomy of the bank. All the world's central banks transfer their monetary income to ministries of finance, which are usually participants in the capital.

While the preferred option would be a "big bang"-type change of the Treaty provisions relating to the budget, it is likely that changing the content of the Treaty on transferring the ECB monetary income directly to the EUB would become a subject of discord between the EU Commission and the euro zone countries. A diluted version of this scenario could be one where the resource represented by the ECB's monetary income tax were replaced with genuine community taxes, provided that the European Parliament would have the ability to legislate on the imposition or withdrawal of authentic community taxes.

There are two different challenges to be solved in this context for scenario 4, which combine taxes imposed by the European Parliament with Member States' contributions. One is to ensure that total taxes will not increase, meaning that Member States will make lower national contributions as part of the total taxes collected directly to the EUB.

The second challenge is to discourage Member States from reducing national contributions too much. One effective way to achieve this goal would be to introduce a separation between decisions on spending and financing. The MFF could focus on the expenditure side of the EUB and leave its funding responsibility to the Council and European Parliament. As in the minimum reform 2020 scenario, in these circumstances the principle

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of "juste retour" would lose its relevance as the ability to pay becomes the most important factor in the collection of revenue for the EUB.

4. Non-tax revenues, collected by the Union's exclusive attributions, are allocated directly to the EUB, involving transfer of ECB monetary income to the EUB. A ,more ambitious variant of this scenario would imply the need for relaxation of the ceiling for OR.

The OR of the EUB, according to scenario 4, would incur the following changes:

- Reduction of the rate based on the GNI resource to 50% of EUB or less;
- Creation of an ACOR, of at least 50% of the EUB;
- Transformation of GNI-based contributions into a progressive model;
- Granting the European Parliament the authority to impose taxes;
- Transferring the ECB's monetary income;
- Relaxation of ceilings for the OR;
- Relaxation of provisions for balancing the budget.

The Community's own resources in 2020 scenario seeks long-term stability based on a balanced division between GNI-based resources (using the continuity of the inter-governmental nature of EU officials) and TOR, as well as other EU own taxes, using new tools. Progression should be adopted for the GNI-based resource. Change to the Treaty would be required for certain options for the resources needed to finance the EUB, including giving greater powers to legislate on the EUB to the Parliament.

### **5. Taxation with representation**

If the Parliament were to be granted legislative powers to determine the financial resources of the EUB and if the ECB's monetary income were to be used for direct financing of the EUB, changes would need to be made to the Treaty<sup>14</sup> for the purpose of introducing taxation by representation, which would provide an EUB financed predominantly by ACOR. VAT, corporation tax (income tax) and eco-taxes, could all be considered as possible options for authentic community financial resources.

OR capping should be subject to relevant analysis of the various financing options for other funding sources so that any new resource is accompanied by a financial study of how it is generated.

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<sup>14</sup> idem

EUB funding resources that could be introduced as new ACOR to replace some of the existing resources could be:

1. VAT at European level;
2. Tax on profits of European companies;
3. Tax on personal income;
4. Environmental taxes;
5. Cashing of atmospheric emissions trading licenses;
6. Individual taxes;
7. Taxes on the flow of information and telecommunications;
8. The European Central Bank's monetary income.

### ***1. VAT at European level***

VAT is currently one OR of the EUB, which at the legislative level is regulated by Directive 112/2006, implemented into national tax legislation of Member States. Although regulated at European level, there are differences in implementing legislation from one state to another, because the Directive not only imposes conditions but also allows Member States some freedom of movement.

This freedom of movement has led to variations in the application of the Directive. These significant differences from one state to another, include the rate of VAT, with the usual political connotations.

As consumption based tax with broad application, and with relatively low rates, VAT can be seen as the most neutral form of taxation, but at the same time, it is unfair because it disproportionately affects low-income individuals.

VAT can be seen as an intra-European tax instrument for tax competition which would allow the use of various instruments to limit it. Based on the "taxation at destination" principle, VAT allows indirect taxation of imports, in the first transaction made after import.

VAT in Europe could play a key role as a potential authentic community resource to finance the EUB if it had a rate / rates applicable in all Member States. Another alternative would be to add a European component to the VAT rates applicable at national level, possibly a percentage (or various percentages), thus making corrections to the current resource based VAT. Adopting this option would require the introduction of European components and the European Parliament would fix the level.

To assess the impact the European component of the rate of VAT would have in Romania, we should consider whether the nominal value would exceed what Romania pays presently as a VAT -based resource to the EUB.

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### ***2. Tax on companies***

Tax on companies or on companies' profits as direct taxes, is levied in the Member States of the European Union. Statistically, the average European level tax is 20% which, given that this rate would be charged at European level would provide ample financial resources to finance the EUB. But tax rates differ essentially from one Member State to another.

It should be noted that, at European level, it is not just tax rates which differ, but their tax base, which would make it difficult to adopt a genuine EU tax on company profits.

At least from a practical perspective, the introduction of income tax at EU level would require the "common consolidated tax return" methodology for calculating the tax base. This measure would aim to create a single taxable base in Europe.

Since varying consolidation schemes lead to different geographical distributions of consolidated tax base, they can lead big companies to relocate their offices from one jurisdiction to another. We must, however, note that, at the Commission level, there is no proposal to harmonise the tax on profits of companies in Member States.

Given that in Romania, most large companies seem to be a part of large European groups, which have their headquarters in other member states, it is expected that the procedure to strengthen the tax base would take place outside Romania, and Romania would receive by distribution a part of the consolidated tax base for which it would be entitled to receive revenue.

### ***3. Personal income tax***

In the Member States of the European Union, income tax rates are very different for individuals. Moreover, in the West, the tax rates are progressive with different rates for higher income earners, while most Member States in Central and Eastern Europe, tax personal income at a flat rate.

Nationwide personal income tax is the most important generator of revenue for the state budget and has great political importance. Its application varies widely from one Member State to another, with different levels and types of deduction, exemption, class taxable income and other differences. For these reasons, personal income tax is a sensitive tax for national economies, and hence it would be very difficult politically to use it as a direct funding resource for the EUB.

#### ***4. Environment taxes***

A whole range of environment taxes which could be used to bring revenue to the EUB, are collected throughout the EU. Even in the Member States with the lowest levels of environment tax, collection reaches more than 2% of GNI.

As required by EU environmental policy, Member States have introduced a whole range of environmental taxes, such as duties (excise duty on motor fuel and fossil fuel in general) and simple forms of taxes and charges (on carbon emissions and greenhouse gas emissions). Transferring these taxes and duties to the EUB as authentic Community taxes would require relevant national and EU legislation as it would be politically difficult for member states to accept the diversion of this revenue from their national budgets.

#### ***5. Proceeds from greenhouse gas emissions trading licenses***

The effort to reduce carbon emissions under the Kyoto Protocol has led to the European Union's Emissions Trading Scheme, which is a market for the trading of emission licenses. The accounting unit for the scheme is the "EU Permit".

The potential revenue of this scheme depends on a wide variety of factors, some of which can be established ex-ante by regulatory decisions. Others will remain unquantifiable until the revenues are realized.

The EU has set an objective to reduce carbon dioxide emissions by 30% by 2020. It has issued a number of permits in the market, which have begun to be traded, in auctions. Member States which have been allocated emission permits, starting from 1 January 2008, were entitled to transact 10% of the market value, which would have generated a considerable financial pressure on polluting companies.

Studies made to assess the potential revenue from trading permits related to carbon emissions show that they represent between 1 / 3 and 2 / 3 of the annual EUB.

#### ***6. Flight taxes for individuals***

Flight tax was introduced in Britain many years ago (Air Passenger Duty), and was paid by people who departed from airports in Britain. The rate was different, depending on class of travel and whether the destination was in Europe or outside. From November 2009, this system was replaced with one based on miles flown (with four different distance bands) and on class of travel.

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One problem facing the UK is that the Chicago Convention, which was created by the International Civil Aviation Organization, bans taxes on the fuel used for international flights. The British authorities argued that Air Passenger Duty is not a tax on fuel and that passengers have accepted it for many years.

If flight tax were used as a resource for the EUB, this might provoke criticism from consumer groups which might argue that it contradicted the EU's policy of liberalization of air services. It might also be criticized as anti-competitive.

However, the tax has the advantage of transparency, which is a point in its favour if it were to be used to finance the EUB. The tax base is estimated to be correct, since the flight distance is easily determined, as is the aircraft, based on its tonnage or other technological criteria. Collection can be made by airlines or airport authorities.

### ***7. Fees for the flow of information and telecommunications***

A potential Community financial resource for the EUB may be a tax charged for a large number of transactions / operations in the field of information transmission, GSM and telecommunications.

Given the development of the communication networks, concern for the continued operation of their impeccable stability effect service quality and the quantities of information to be transmitted, the adoption of this tax at EU level would create stable financial resources for the EUB. It remains questionable, however, how such a tax would be collected, the collecting authority and the mechanism for payments to be made to the EUB.

### ***8. Monetary income of the ECB.***

The legal and political justification for the transfer of these revenues to the European Union would be fundamentally correct, if the single currency were to circulate in all Member States. However, this idea should be considered in the light of the statutory provisions of Economic and Monetary Union and we believe that it requires extensive consultation within the European System of Central Banks.

## **3.9. Conclusions on the implications of the reform of financial resources on Romania's contribution**

Although through the answers to the questions in the questionnaire launched for public consultations, Romania, through the Finance Ministry, has expressed its opinion with respect to the reform of the financial

resources of the EUB as supportive of the reform in the manner described in scenario one, we should take into account:

1. clearly tracing the national interest in all the approaches and decisions that would be taken to support the reform of the EUB's financial resources, which could further ensure the continuation of the cohesion and solidarity policies- thus maintaining Romania's position as a net beneficiary - with positive effects for development, growth and employment;

2. In the spirit of transparency and providing information to Romanian taxpayers, institutions involved in this process are to make known the measures and decisions taken, both in terms of the expected financial impact of reforms on public expenditure representing Romania's contribution to the EUB and the legal measures to be taken, namely the adoption of internal rules of law governing Romania's strategy for the reform of the EUB's financial resources;

3. maintaining sovereignty and fiscal neutrality, while the EU, through the European Parliament has yet to establish tax powers at European level;

4. under European cohesion policy and solidarity, supporting the elimination of the correction-equalization mechanisms in the EUB;

5. supporting the GNI-based contribution as the primary financial resource, and the gradual phasing out of the resource based on VAT and correction mechanisms-equalization applied individually;

6. being open to serious reform of the financial resources of the EUB system while supporting the contribution of resources to the EUB and the gradual transit to a system based on ACOR, at the same pace as the development and growth of the Romanian economy;

7. as the economy develops and grows, to promote a smooth transition system based on national contributions to the ACOR, but maintaining the GNI-based contribution as a primary resource, with a diminishing trend of its share in total financial resources;

8. where, after consultations and negotiations, there is a conclusion in favor of imposing an ACOR type tax, we could consider potential taxes, which are not yet revenues to the state budget of Romania, such as:

a. The fee for the flow of information and telecommunications, which would have broad application in Romania, but keeping this tax at a reasonable level;

b. taxes for planes departing from Romania;

c. licensing fees from emissions trading.



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Establishing some of these charges would not lead to a reduction in existing revenues of the Romanian state, but rather, in perspective, would not be able to receive a potential income tax.

The introduction of these taxes at EU level should be accepted by all EU Member States.

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## **ABBREVIATIONS**

- ABAS – Accrual Based Accounting System
- ECB – European Central Bank
- EUB – EU Budget
- ECS – European Coal and Steel
- MFF – Multi-annual Financial Framework
- DGB – Directorate General of Budget
- ERDF – European Regional Development Fund
- EAGGF – The European Agricultural Guidance and Guarantee Fund
- ESF – European Social Fund
- FTS – Financial Transparency System
- IIWG – Inter-institutional working group to formulate the position of Romania
- FIFG – Financial Instrument for Fisheries Guidance
- IASPS – International Accounting Standards in Public Sector
- CAP – Common Agricultural Policy
- SGP – Stability and Growth Pact
- GDP – Gross domestic product
- OR – Own resources of the Community budget
- CORA – Community own resources authentic EUB
- TOR – Traditional own resources of the Community budget
- VAT – Value Added Tax
- EMU – Economic and Monetary Union
- EU – European Union
- GNI – Gross national income