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Agenda 2007 – The Conflict over the Financial Framework 2007-2013

Roman Maruhn und Janis A. Emmanouilidis

Key points:

- The Commission's draft budget for 2007-2013 includes an increase in EU expenditures in both absolute terms and in relation to the member states' cumulated gross national income (EU-GNI). Nevertheless, the draft, which foresees an average expenditure of 1.14 percent of the EU-GNI, remains clearly below the maximum expenditure ceiling of 1.24 percent.
- Given the member states' diverse interests, one can expect that the negotiations on the financial framework will not be completed before 2006 under the Austrian or Finnish Presidency.
- A scenario in which the member states are unable to agree on a new financial framework, which would lead to a continuation of the budget based on the upper ceilings of the current financial perspective (Agenda 2000), should not be assumed.
- At the end of the negotiating process, the total amount of expenditures for the 2007–2013 financial framework will be considerably less than the Commission's original proposal. Average expenditures of approximately 1.05 percent of the EU-GNI appear realistic.
- Negotiations over agricultural policy are not expected to bring about massive changes. The cap on agricultural expenditures agreed on in 2002/2003 will remain in place.
- The negotiations for the financial framework will focus on European structural and regional policy. The former "Objective 1" regions in the old member states will continue to be supported over the duration of the next financial framework. However, the level of support will be gradually reduced.
- The negotiations on the Agenda 2007 should not be determined solely by national financial interests, but should also be guided by general principles for defining the Union's budget. These include a stronger concentration on the EU's future agenda, the ideal of a European added value and the principle of solidarity.

The negotiations on the Agenda 2007 are entering a decisive phase. At the EU summit in December 2004, the Luxembourg Presidency was charged with making rapid progress in the consultations on the financial framework 2007–2013, in order to reach a political agreement by June 2005. However, it has already become apparent that an agreement on one of the most difficult questions of European *realpolitik*, involving up to 1000 billion euro, will be even more

Bertelsmann Foundation, Carl-Bertelsmann-Str. 256, D-33311 Gütersloh, Phone: +49 52 41/81-8 15 19 (Gütersloh), +32 2/2 80 28 30 (Brussels), email: peter.zervakis@bertelsmann.de; annette.heuser@bertelsmann.de; URL: http://www.bertelsmann-stiftung.de

www.eu-reform.de

Centre for Applied Policy Research, Maria-Theresia-Str. 21, D-81675 München, Phone: +49 89/21 80-13 36, Fax: +49 89/21 80 13 29, email: janis.emmanouilidis@lrz.uni-muenchen.de; URL: http://www.cap.uni-muenchen.de

difficult than the accord reached in 1999 on the Agenda 2000. The national positions of the 25 governments are far apart. And the European Commission is in the difficult position of finding a compromise among the various positions of the member states, without losing sight of the interests of the EU as a whole.

Against this background, this paper discusses and evaluates the proposals made by the Commission, analyzes the positions of the member states, and sketches the coming course of the negotiations as well as the foreseeable results of the negotiations on the Agenda 2007. Based on this prognosis, a number of basic principles are developed that could serve to frame the debate about the Agenda 2007.

Starting Position

The essential starting point for the negotiations is still the draft financial perspective (see Table 2) presented in February 2004 by the Prodi Commission and retained by the new Commission President, José Manuel Barroso. This draft was extended and made more precise by additional Commission proposals in the context of the Third Cohesion Report (February 2004), the Own Resources Report and the package of detailed legislative proposals (both July 2004).

In addition to the administrative costs, the Commission’s draft budget provides for four major areas of expenditure: (1) *sustainable growth* (comprised of the sub-areas competitiveness and cohesion); (2) *sustainable management and protection of natural resources* (comprised of the classic support for agriculture and measures to promote rural areas); (3) *citizenship, freedom, security and justice;* and (4) *the EU as a global partner*.

According to the Commission’s plans, the total amount of expenditures over the 2007–2013 period is estimated to reach 928.7 billion euro in appropriations for payments. The total appropriations for commitments, that is funds that political measures in the budget could convert into disbursements, reach 1025.04 billion euro. It should however be noted that the annual budgets that were actually passed in the last years came in considerably below the level originally agreed on in the financial perspective. Thus the current budget for 2005 calls for expenditures of 106.3 billion euro. The projected 2005 budget in the Agenda 2000, updated for 25 members, included appropriations for payments of 112.26 billion euro, and appropriations for commitments of 117.53 billion euro.

In the case of payment appropriations, a direct comparison of the last fiscal year in the Agenda 2000 (2006: 114.8 billion euro) with the last fiscal year in the Agenda 2007 (2013: 143.1 billion euro) shows an absolute increase of expenditure of almost 25 percent. The appropriations for commitments show an increase of 31 percent. The average annual expenditures planned by the Commission for 2007–2013 are approximately 16 percent higher than the funds appropriated for the fiscal year 2006. The Commission has justified the expansive spending by noting that the tasks of the European Union are continually increasing, and that the number of member states and their socio-economic heterogeneity have both grown significantly.

Based on the EU budget's (appropriations for payments) relative share of the member states' cumulative gross national income (EU-GNI), the Agenda 2007 shows an increase from 1.09 percent (2006) to an average of 1.14 percent (2007–2013), with a peak of 1.23 percent in 2008. These figures assume an average annual economic growth of 2.3 percent. In case the actual growth rate in the 2007–2013 period is lower, the expenditures would increase as a share of EU-GNI.

A closer look at the distribution of the budget shows that the Commission's proposals affect the individual areas of expenditure quite differently, compared with their levels of funding in the Agenda 2000 (see also Table 2):

- The share of costs for the areas of *administration* (2007–2013: 28.62 billion euro) and *the EU as a global partner* (2007–2013: 95.59 billion euro) remain the same. In absolute terms, however, the expenditures rise 31 percent and 40 percent, respectively, in a direct comparison between 2006 and 2013.
- In contrast, the average share for the area of *competitiveness* (2007–2013: 132.75 billion euro), which as a subtitle of the expenditure area *sustainable growth* (2007–2013: 477.66 billion) is devoted primarily to the support of the Lisbon goals, doubles in the EU budget for 2007–2013 compared with the 2006 budget. In absolute terms, this will almost equal a tripling of the annual expenditure, from 8.79 billion euro in 2006 to 25.82 billion euro in 2013.
- The expenditures for *cohesion* (2007–2013: 344.91 billion euro), which is also a subtitle of the expenditure area for *sustainable growth*, increases its share only marginally, from 32.1 percent to 33.6 percent. In absolute terms, however, this will mean an increase from 38.79 billion to 50.96 billion euro.
- The expenditures in the field of *citizenship, freedom, security and justice* witness a particularly strong relative growth (2007–2013: 18.50 billion euro). The funding provided for this area increase from 1.1 percent in 2006 to an average of 1.8 percent of the total budget in the 2007–2013 period. In absolute terms, this means an increase from 1.38 billion euro to 3.62 billion euro.
- In contrast, the spending for *sustainable management and protection of natural resources* shrinks as a share of the total budget, from 46.4 percent (2006) to 39.5 percent (average 2007–2013). The spending for classic agricultural policy ("market related expenditure and direct payments") drops even more sharply, from 36.2 percent (2006) to 29.4 percent in (2007–2013). In absolute terms, annual total spending for the *sustainable management* area is to be fixed at roughly 58 billion euro.

Evaluation of the Commission's Proposals

The Commission's proposals envisage a number of changes to the European Union's current budget structure. How can these proposals be evaluated?

- The Commission's attempt to explain its budget proposals ("bottom-up approach") is a positive development. The Commission's communication titled "Building Our Common Future: Policy Challenges and Budgetary Means of the Enlarged Union 2007–2013" in large parts resembles a political program.
- As the Agenda 2007 is inseparable from the medium-term picture of the EU's *finalité*, the Commission should have used the opportunity to examine individual policy areas more closely in terms of their cost efficiency. In this respect, the results of the Sapir report, which was published in July 2003 and which primarily examined the growth effects of EU policies and called for a reduction of subsidies, should have been taken into account more thoroughly.
- The Commission's draft budget includes an increase of EU expenditures in both absolute terms and in relation to the member states' cumulated GNI. Nevertheless, the Commission, which as a college was deeply divided over this question, did not choose to set the budget at the maximum level. At an average of 1.14 percent of the EU-GNI, the draft remains clearly below the maximum expenditure ceiling of 1.24 percent. In contrast, critics of the Commission's proposal argue that an increase of the average annual EU budget for the 2007–2013 period by 16 percent, compared to the budget plan for 2006, comes close to a maximalist political position in a time of tight national budgets.
- It is important to note that the relative share of expenditures for agriculture, and particularly the spending for agricultural subsidies, is scheduled to be reduced. This relative reduction, however, does not come at the behest of the Commission. It is the result of the agricultural compromise reached in October 2002 / June 2003, where the EU member states decided to cap spending in agricultural policy.
- A crucial shift in the EU budget would result from the fact that the spending devoted to the support of economic development is scheduled to be substantially increased. According to the Commission's plans, the goals of the Lisbon Strategy – according to which the EU wants to become the most competitive economic area in the world by 2010 – should be reflected in the Union's budget. Critics of this approach argue that the Commission assumes that increasing the EU budget, and not consolidating public spending at the European level, is the way to spur economic growth.

Member State Positions

In the course of the debate about the financial perspective and on the basis of the reactions to the Commission's proposals, one can identify four groups of member states, which in part represent strongly opposing interests:

- *Net contributors:* The first group is comprised of the Union's net contributors, states that are resisting a relative increase in the size of the EU budget in relation to the EU-GNI. Thus, already on 15 December 2003, a joint letter from Austria, France, Germany, the Netherlands, Sweden and the United Kingdom to Commission President Prodi ("letter of the six") called for capping real EU expenditures at 1 percent of the EU-GNI (corresponds to 815 billion euro of appropriations for commitments). These countries justify their position by citing the need for national budget discipline, in part as a requirement of the rules laid down by the Stability and Growth Pact. Furthermore, the group of net contributors argues that even with an expenditure limit of 1 percent, the EU budget will continue to grow as a result of both economic growth and inflation. They argue that this rate of increase must be sufficient to compensate for the additional costs resulting from EU enlargement. Critics of this position argue that the group of net contributors is following a top-down approach that first sets financial limits, instead of determining the necessary financial means on the grounds of the real costs of an EU-25+.

- *Old net recipients:* The second group is comprised primarily of the old net recipients from the EU-15, who want to continue to profit from payments out of the EU budget even after 2006. This group includes member states such as Greece, Portugal or Spain, which aspire to be supported by means from the structural and regional funds also in the future, despite EU enlargement and the shifts of prosperity resulting from the accession of poorer countries to the Union.

- *New net recipients:* The third group is comprised of the member states from Central and Eastern Europe that will be net recipients over at least the medium term. These countries, – like the group of old net recipients – are able to take up most of the Commission's proposals. The implementation of the Commission's proposals would be in their interest, in order to speed up progress towards equal levels of prosperity within the EU with the help of financial assistance coming from Brussels. The Commission's draft devotes half of the cohesion funds to the new EU members, although they represent only 27 percent of the total population.

- *United Kingdom:* The UK is a special case in the negotiations on the financial framework. Similar to its stance during the negotiations on the Agenda 2000, the government in London is not prepared to give up the British rebate. However, the repayments from the EU budget that were negotiated by the Thatcher government in 1984 are no longer appropriate for numerous reasons. First, as a result of reductions in expenditure for agriculture and the increase of funding for rural development, the EU budget has changed substantially to the UK's advantage. Further, over the last 20 years British economic strength has increased noticeably, even when compared with other European economies.
  According to calculations by the Commission, the rebate paid to London would actually increase, from 4.3 billion euro annually over the period 1997–2003 to 7.1 billion annually beginning in 2007 if the present system is preserved. In this case, the UK's net contribution would amount to 0.25 percent of its gross domestic product (GDP), compared with 0.56 percent for the Netherlands, 0.54 percent for Germany, 0.41 percent for Italy and 0.37 percent for France. By reasons of financial fairness and in view of the increasing burdens that enlargement has placed on the EU budget this imbalance is no longer justified.

As an adoption of the Agenda 2007 requires consensus among all EU member states, the negotiating process will have to bring these diverging interests together. What course will the negotiations take, and what final results are to be expected?

Course of Negotiations and Prognosis

At the EU summit in December 2004, the Heads of State and Government agreed that the Luxembourg Presidency should reach a "political agreement" by June 2005. From the Commission's point of view, this schedule is a precondition for developing the next generation of support programs before the Agenda 2000 expires in 2006, so that the new programs can begin according to plan in 2007.

Given the extremely heterogeneous interests involved, this schedule appears unrealistic. It is much more likely that the approval of the next financial framework will be delayed considerably, as was the case with the Agenda 2000. The extensive working agenda for the first half of 2005, along with elections to the British House of Commons during the same period, make a compromise under the Luxembourg Presidency very difficult. Because of London's special position (British rebate), the financial negotiations will most likely not be concluded during the UK Presidency in the second half of 2005. Thus, negotiations will continue into 2006 under the Austrian and Finnish Presidency.

By that time, one can expect that the factual arguments will have faded even further into the background and that the consultations will be increasingly dominated by national budgetary interests.

Taking into account the negotiating positions of the member states and the proposals made to date by the Commission, the probable results of the negotiations can be forecast. If negotiations follow the logic of consultations on previous EU budgets, one can expect the following results:

- The member states, the Commission and the European Parliament will agree on a compromise for the Agenda 2007 till the end of 2006. A scenario in which the member states are unable to agree on a new financial framework, which would lead to a continuation of the budget based on the upper ceilings of the current financial perspective (including increases set by the average rate of increase in the Agenda 2000), should not be assumed because of the foreseeable and lasting damage to European policy-making.
- In view of the total amounts committed by the next financial perspective, one can expect that the final result will be noticeably less than the original proposal from the Commission. The average level of expenditure of 1.14 percent of EU-GNI will be reduced during the negotiations. Sources within the Commission and the Luxembourg Presidency have already signaled that the average level of expenditure could be set at around 1.05 percent of EU-GNI. Such a result would resemble the compromise in 1999, when the financial framework of the Agenda 2000 was roughly 10 percent below the Commission's original draft.

- Massive changes should not be expected in the negotiations over agricultural policy. Even though calls for such changes have been made in a number of member states and the European Parliament, it is not likely that the agreed cap on agricultural spending will be placed on the negotiating table. The absolute limit on expenditures for agriculture will not be substantially altered in the negotiations for the Agenda 2007. This assessment is supported by the fact that Germany and France, as well as a majority of member states, have on numerous occasions spoken out against a revision of the compromise of October 2002 / June 2003.

- The financial negotiations will primarily focus on European structural and regional policy. Based on the presumption that the socio-economic disparities will double in an EU of 27 members, the Commission has already tabled a number of concrete proposals. For example, these proposals include generously designed phasing-out regulations to ensure that recipients of regional development aid are not deprived of funds from Brussels overnight. In general, one can expect that regions in the old member states that would fall out of Objective 1 support (less than 75 percent of average GDP per capita) because of statistical effects related to enlargement will be supported over the course of the next financial framework. Nevertheless, it should also be expected that the support for the old Objective 1 regions will be gradually reduced. The length of the transition period and the amount of funds to be appropriated must still be negotiated.
  What is also important is the fact that the financial flows from regional support will continue to be limited to a maximum of 4 percent of GDP. This will limit the payments to the new member states, which, compared with the old EU states, have a relatively low GNP. The remaining resources from the structural and regional funds can be used to continue the support for the old recipient regions.

- Any attempt to end the British rebate will likely fail in the face of vehement resistance from the British government. What is politically more likely is the introduction of a general mechanism to reduce the burden on net contributors. The renewed Commission proposal for a *generalized correction mechanism* to cap net contributions to the EU budget might serve as a basis. In the event that a general refund mechanism is introduced, which would be applied as soon as the net contribution of a member state exceeds 0.35 percent of national GDP, the British contribution to the EU would substantially increase. As a result, the other net contributors – primarily France, Germany, Italy and the Netherlands – would financially be relieved. As the Commission's proposal would mean a doubling of the UK's net contribution (from 0.25 percent of GDP to 0.51 percent), a final compromise based on the correction mechanism would require some concessions to Britain. Particularly sensitive from a political point of view is the fact that the model of a *generalized correction mechanism* could drive a wedge between the United Kingdom and the other authors of the "letter of the six."

Basic Principles for Defining the EU Budget

The above outline of the foreseeable outcome of the negotiations on the Agenda 2007 makes one thing perfectly clear: The negotiations are primarily dominated by the national financial interests of the member states, and not by any overarching principles defining the European budget.

That is precisely the problem. There is no broad agreement about general principles that could shape the discussions on the budget. The current debate about the Agenda 2007, as well as future negotiations about the EU's financial constitution, should adhere to the following three basic principles:

(1) Concentration on the future agenda

The EU budget should increasingly concentrate on financing future-oriented projects, and give up the existing orientation toward an agenda of the past. The proposed relative reduction of expenditures on the Common Agricultural Policy as a share of the total budget points in the right direction. But only a further reduction of agricultural subsidies can create the financial flexibility necessary to fund a future-oriented agenda for the EU.

The central tasks of this future-oriented agenda include:

(i) *The promotion of Europe's competitiveness:* A simple increase of the funds available for this task – as proposed in the Commission's plans – will not suffice. Success depends much more on concentrating the available resources on existing European Centres of Excellence, instead of spreading the means around by sharing it "fairly" among all the member states.

(ii) *The EU's increasing global responsibility:* In order to translate the European Security Strategy into concrete policies, the EU budget must provide more resources to finance foreign policy activities. The principle in use to date, under which the participating member states bear the operational costs of an operation themselves ("costs lie where they fall"), should be changed in favour of a fair division of costs. This would impose the costs of foreign policy actions, which benefit not only the member states that take part in a mission but the Union as a whole, on all EU states.

(iii) *(Co-)Financing of differentiation projects that drive integration:* Cooperation projects that are initiated by a group of member states within the framework of the EU should be supported by the Union's budget. If these forms of cooperation aim to further the objectives of the Union, protect the EU's interests and reinforce the integration process as a whole, as required by the current Treaties and the European Constitution, the operational costs of cooperation should not be borne exclusively by the participating states. Instead, such projects should at least be co-financed from the EU budget.

(iv) *Strengthening internal security:* Success in the fight against organized crime and international terrorism depends far more than other policy areas on the close and effective cooperation between the member states. Although the Commission's draft proposes an increase of the budget in this area compared with the Agenda 2000, it is very questionable whether the proposed resources are sufficient to accomplish this task.

(2) European added value

The structure of the EU budget and the distribution of financial resources should be guided by the question of whether providing funds at the European level brings advantages for the Union as a whole. The budget should support projects and measures

- through which member states' resources can be saved or more effectively used if national financial resources are pooled (e.g. research and development, defence procurement);
- that have cross-border effects, from which several EU states or the Union as a whole can profit (e.g. improved mobility, increased growth);
- that have modernization effects that could not be achieved solely through national efforts.

On the grounds of the idea of a European added value and the principle of subsidiarity it must also be possible to re-transfer tasks from the European level to the national level, if the benefits of common financing no longer exist.

(3) Solidarity principle

Finally, the EU budget should live up to the principle of solidarity anchored in the European constitution. In a socio-economically heterogeneous EU of 25 and more member states, resources should be concentrated on the regions most in need of them. The phasing out of support for the former Objective 1 regions in the old member states should be implemented with rapid speed. The readiness of the old member states to show their solidarity will significantly influence popular support in the new member states for continuing the process of integration.

Table 1: The Road to the Agenda 2007

15 December 03	Net contributors publish the "letter of the six"	✓
2004	Negotiations over the 2007–2013 financial framework begin under the Irish Presidency	✓
10 February 04	The Commission presents its draft for the 2007–2013 financial framework	✓
18 February 04	Presentation of the Third Report on Economic and Social Cohesion in the European Union	✓
2 April 04	First ECOFIN talks on the financial framework are held in Punchestown	✓
21 April 04	The European Parliament adopts guidelines for the 2007-2013 financial perspective	✓
17-18 June 04	Presentation to the European Council of the report prepared by the Irish Presidency on the financial framework for 2007–2013	✓
1 July 04	Continuation of negotiations on the financial framework 2007–2013 under the Dutch Presidency	✓
14 July 04	The Commission presents the Own Resources Report and tables a package of detailed legislative proposals for the financial perspective	✓
13 September 04	First debate in the Council "General Affairs and External Relations"	✓
17 December 04	European Council confirms the own resources ceiling of 1.24 percent of EU-GNI for the Agenda 2007	✓
1 January 05	Luxembourg assumes the EU Presidency	✓
Spring 05	Planned presentation of a complete Commission draft for the financial framework	?
June 05	Target date for acceptance of the financial framework by the European Council (political agreement)	?
1 July 05	The United Kingdom assumes the EU Presidency	!
End of 05	Target date for EU member states' agreement on the financial framework 2007–2013 (formal decision)	?
1 January 06	Austria assumes the EU Presidency	!
Spring 06	A compromise might only be found now, as was the case in the negotiations on the Agenda 2000	!
1 July 06	Finland assumes the EU Presidency	!
2006	The legal instruments for the financial framework must be put into place to guarantee efficient implementation of the financial planning	!
2007	First fiscal year of the 2007–2013 financial framework	!
2011	Probable start of negotiations for the subsequent framework	?
2013	Last fiscal year of the 2007–2013 financial framework	!
2014	Start of the financial framework 2014–2018 (future framework duration will be five years)	!

Table 2: EU Policy Fields and Their Budgets Under the Financial Framework 2007–2013

	AGENDA 2000		AGENDA 2007								
Budget item	2006	2006 %(1)	2007	2008	2009	2010	2011	2012	2013	07–13 Total	07–13 %(2)
1. Sustainable Growth	**47,582**	**39.4**	**59,675**	**62,795**	**65,800**	**68,235**	**70,660**	**73,715**	**76,785**	**477,665**	**46.6**
of which: 1a. Competitiveness for growth and employment	8791	7.2	12,105	14,390	16,680	18,965	21,250	23,540	25,825	132,755	13.0
of which: 1b. Cohesion for growth and employment	38,791	32.1	47,570	48,405	49,120	49,270	49,410	50,175	50,960	344,910	33.6
2. Sustainable management and protection of natural resources	**56,015**	**46.4**	**57,180**	**57,900**	**58,115**	**57,980**	**57,850**	**57,825**	**57,805**	**404,655**	**39.5**
of which: Agriculture – market related expenditure and direct payments	43,735	36.2	43,500	43,673	43,354	43,034	42,714	42,506	42,293	301,074	29.4
3. Citizenship, freedom, security and justice	**1381**	**1.1**	**1630**	**2015**	**2330**	**2645**	**2970**	**3295**	**3620**	**18,505**	**1.8**
4. EU as a global partner	**11,232**	**9.3**	**11,400**	**12,175**	**12,945**	**13,720**	**14,495**	**15,115**	**15,740**	**95,590**	**9.3**
Administration	**3436**	**2.8**	**3675**	**3815**	**3950**	**4090**	**4225**	**4365**	**4500**	**28,620**	**2.8**
Compensations	1041										
Total appropriations for commitments	**120,688**	**100**	**133,560**	**138,700**	**143,140**	**146,670**	**150,200**	**154,315**	**158,450**	**1,025,035**	**100**
Total appropriations for payments	**114,740**	-	**124,600**	**136,500**	**127,700**	**126,000**	**132,400**	**138,400**	**143,100**	**928,700**	-
Appropriations for payments as a percentage of GNI	1.09%	-	1.15%	1.23%	1.12%	1.08%	1.11%	1.14%	1.15%	-	1.14%
Margin available	0.15%	-	0.09%	0.01%	0.12%	0.16%	0.13%	0.10%	0.09%	-	0.10%
Own resources ceiling as a percentage of GNI	1.24%	-	1.24%	1.24%	1.24%	1.24%	1.24%	1.24%	1.24%	-	1.24%

All figures in million euro at 2004 prices

Sources: Commission of the European Communities: Communication of the Commission to the Council and the European Parliament: "Building Our Common Future. Policy Challenges and Budgetary Means of the Enlarged Union 2007–2013." Brussels, 10 February 2004, COM(2004) 101 final/2, p.29 (English version); own calculations.

(1) percentage share; (2) percentage share over the 2007–2013 period