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**Article**

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Intereconomics

# Commission Proposals on Budgetary and Financial Reform

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**In a speech to the European Parliament on 18th February 1987 the Commission President Delors publicly announced the Commission's proposals for a fundamental reorganization of the system of financing the Community and of Community budgetary policy.[1] What is the background of these proposals? How can they be assessed?**

In putting forward its proposals, the Commission honoured the undertaking given at the Fontainebleau European Council in June 1984, that one year prior to exhaustion of the Community's own resources the Commission would submit a report on the Community's financial requirements, on the outcome of the policy of budgetary discipline adopted by the Council and on the sharing-out of budgetary burdens among the Member States.[2]

The Commission's proposals constitute more than the financial and budgetary report called for, however. The very title of the Commission document – "Making a success of the Single Act – a new frontier for Europe" – is indicative of a comprehensive attempt to resolve budgetary and financial problems within an overall Community development strategy. The following brief review of Community budgetary policy will be conducive to a better appraisal of the new Commission proposals.

Nothing less than persistent financial "crisis" would appear to be characteristic of Community budgetary policy. According to Article 199 of the EEC Treaty, expenditure and revenue under the Community budget should be in balance; in recent years, however, it has proved impossible to prevent expenditure outstripping the Community's own resources. The Community is financed by means of "own resources", which, at present, essentially consist of customs duties, agricultural levies and value-added tax of up to 1.4%, applied on a uniformly determined basis. The most recent decision to adjust the system of revenue was taken at the Fontainebleau European Council in 1984 after negotiations lasting almost four years.[3]

Since decision-taking on increasing own resources was a protracted process, the Member States were obliged to provide additional funding for the Community budget in both 1984 and 1985. In 1984, the Member States contributed a further 1,001.8 million ECU by way of refundable advances, while additional funding for 1985 (1,981.6 million ECU) took the form of non-refundable advances.

In order, however, to balance the budget pursuant to Article 199, at least on paper, major items of expenditure were deferred to subsequent years in both 1984 and 1985. The Court of Auditors condemned this policy in its annual report concerning the financial year 1985: "For the second year running, the Communities have not observed one of the fundamental principles upon which

* Secretariat General of the European Parliament. The article expresses the author's personal opinion.

[1] COM(87) 100 final of 15th February 1987.

[2] Bull. EC 6 – 1984, para. 1.1.1. ff.

[3] Agreement on the specific rules governing budgetary discipline was not reached until the Dublin European Council on 4th December 1984, however. According to the European Council's conclusions, *inter alia* the average increase in agricultural expenditure over a three-year period should not exceed the increase in the Community's own resources base. Cf. Bull. EC 12 – 1984, pp. 24 ff.

their financial organization is based, namely the need to cover fully each year's financing needs with the equivalent amount of annual revenue."[4]

### Expenditure Trends

The continuing debate on additional financial resources for the Community could easily give the impression that there has been a very large, continuous increase in Community expenditure in past years. Table 1 illustrates the relatively low volume of the Community budget and also reveals that, compared with Member States' GNP or national budgets, Community budget expenditure has risen considerably more slowly in the 1980's than in the 1970's. The accession, since 1980, of three Member States to the Community (Greece in 1981, and Spain and Portugal in 1986) must also be borne in mind.

Expenditure trends in individual policy areas are particularly interesting (cf. Table 2). Comparison of agricultural expenditure trends with spending trends in other budget areas, if full account is taken of the cost of storing farm produce,[5] reveals that expenditure in agriculture has increased more than spending elsewhere and, in particular, has risen more than Community own resources. The increase in agricultural expenditure – some 60 % of the total 1987 budget of more than 40 billion ECU – is thus a decisive factor accounting for the strain on the Community's finances.

### Revenue Trends

Not only increased expenditure, but also the Community's present system of own resources is responsible for the financial problems. Traditional own resources (customs duties and agricultural levies) are falling as a result of multilateral reductions in import duties and the growing agricultural self-sufficiency of the Community (cf. Table 3). The VAT base itself is growing at a slower rate than Community economic activity because the relative share of Community GDP accounted for by private consumption is falling. This restriction on the Community's VAT own resources has been compensated for by the decision to increase the VAT ceiling.

[4] Annual Report of the Court of Auditors concerning the financial year 1985, OJ No. C 321, 15. 12. 1986, p. 13.

[5] On pp. 7 and 43 of document COM(87) 101 final, the Commission calculates that, for 1987, the book value of agricultural stocks – 12.3 billion ECU – should be depreciated by 66 %. Depreciation within the budget has only taken place on a fairly modest scale. To cover all costs relating to agricultural policy, additional depreciation of some 6 billion ECU should be provided for. In its annual report concerning the financial year 1985 (pp. 42 ff.) the Court of Auditors has already pointed out that stock depreciation must take place, that in the absence of full depreciation expenditure on measures to reduce stocks must be deferred and that this provides an inaccurate impression of the cost of the CAP.

**Table 1**
**Community Budget Trends**

| | Community Budget (in bn ECU) | As a Percentage of Member States' National Budgets | As a Percentage of Community GNP |
|---|---|---|---|
| 1973 | 4.6 | 2.0 | 0.53 |
| 1974 | 5.0 | 1.9 | 0.51 |
| 1975 | 6.2 | 1.8 | 0.55 |
| 1976 | 8.0 | 2.1 | 0.61 |
| 1977 | 8.5 | 2.1 | 0.60 |
| 1978 | 12.4 | 2.6 | 0.79 |
| 1979 | 14.1 | 2.7 | 0.83 |
| 1980 | 16.0 | 2.7 | 0.80 |
| 1981 | 17.9 | 2.4 | 0.81 |
| 1982 | 20.7 | 2.5 | 0.86 |
| 1983 | 22.9 | 2.5 | 0.89 |
| 1984 | 25.4 | 2.6 | 0.91 |
| 1985 | 28.1 | n.a. | 0.94 |

Source: EC Commission.

**Table 2**
**Trends in Nominal Community Budget Expenditure in Individual Policy Areas from 1980 to 1987**
(Annual increase in percent)

| | |
|---|---|
| 1. **Common Agricultural Policy** (Guarantee Section) | |
| (a) not including all storage costs | 12.5 |
| (b) including all storage costs | 15.9 |
| 2. **Regional policy including transport** | 13.9 |
| 3. **Social policy** | 19.7 |
| 4. **Research and energy policy** | 17.4 |
| 5. **Development policy** | 13.4 |
| 6. **Community own resources (for comparative purposes)** | 12.5 |

Source: Commission and own calculations.

**Table 3**
**Increase in Community Own Resources**

| | 1980 m ECU (EUR-9) | 1986 m ECU (EUR-12) | Real-term growth or decline (in %)[1] 1980-86 | 1986-92 |
|---|---|---|---|---|
| 1. Traditional own resources | 7,908 | 12,399 | – 3.3 | – 2.0 |
| 2. VAT | 7,258 | 22,468 | 8.3 | 2.1 |
| 3. Other | 900 | 307 | ... | ... |
| Total | 16,066 | 35,174 | 2.3 | 0.6 |

[1] Real annual per capita growth rate 1986-1992: VAT estimate based on a 1.4 % call-in rate.
Source: EC Commission.

**Table 4**
**Actual Budget and Required Budgets**

| | 1983 | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|---|
| 1. Actual VAT rate in budget (%) | 1.00 | 1.14 | 1.23 | 1.40 | 1.39 |
| 2. VAT rate required for proper financing (%) | 1.22 | 1.28 | 1.40 | 1.60 | 1.65 |
| 3. Accumulated liabilities in bn ECU | 3.0 | 6.0 | 8.6 | 12.2 | 17.00 |

Source: COM(87) 101 final.

### Scale of the Financial Crisis

Comparison of the financial resources actually required by the Community and the maximum level of own resources accruing to it in recent years clearly demonstrates the scale of the financial crisis. The Commission's calculations, reproduced in Table 4, are an attempt to illustrate the level of revenue required to implement a proper budget rather than the budget adopted, the latter being, according to the Commission, underfunded and caught in a "morass of budgetary malpractices".[6]

It should be pointed out that, until 1985, the Community was entitled to call in VAT up to a ceiling of 1 % only and that the current call-in rate is limited to 1.4 %. The Commission's calculations of the actual VAT call-in rate required demonstrate that the Community has exceeded its financial coverage since 1983.

According to the Commission's calculations, the Community's accumulated liabilities now total 17 billion ECU. These liabilities stem from very different developments: stock value must be depreciated, as has already been mentioned, and the Community has entered into commitments in various policy areas which will have to be financed in due course.

Comparison of the Court of Auditors' estimate of future commitments relating to 1985 – 20 billion ECU – with the Commission's calculations demonstrates that such figures can only be a rough guideline.[7] It must therefore be stressed, in order to prevent misinterpretation, that such calculations of liabilities can only give some idea of the actual level of commitments chargeable to subsequent budgets and that such liabilities do not constitute legally enforceable commitments on the part of the Community. "Liabilities" should be broken down into two categories:

□ previous commitments relating to agricultural surpluses and stocks which were not scheduled but arose automatically from agricultural policy decisions and should have been catered for in the budget if financial management had been sound;

□ multiannual commitment appropriations relating to other policy areas, reflecting budgetary policy-making and future spending priorities.

To sum up: events have demonstrated that budgetary policy-making does not provide for ceilings on Community expenditure under the EAGGF Guarantee Section. Budget estimates for such expenditure are simply that: estimates of expected spending. The annual estimates of expenditure are modified by agricultural policy-making, such as the farm price decisions, or by external factors such as changes in the dollar exchange rate. Budget estimates for spending in areas other than agriculture cannot be exceeded by the Commission when implementing the annual budget.

### The Commission's New Proposals

The Commission is proposing three major changes to the current own resources system:

□ The new ceiling on Community revenue should be expressed in terms of GNP. Until 1992 it would be possible to raise this ceiling to a maximum of 1.4 % of Community GNP. This corresponds to an amount of 57.000 million ECU compared to 39.680 million ECU, which the Commission calculates for 1992 on the basis of the unchanged revenue system.

□ The composition of Community resources would be modified. While customs duties and agricultural levies would continue to accrue to the Community, VAT arrangements would be modified: instead of the current system, whereby up to 1.4 % of a harmonized VAT base accrues to the Community, 1 % of the base actually subject to VAT would be paid to the Community.

□ An additional base, representing the difference between the Member States' GNP and the actual VAT base would be introduced. A uniform call-in rate, to be set annually, would be applied to this additional base – for 1987, for example, a level of 0.3 % has been proposed – enabling the GNP ceiling for the financial year to be observed.

To all intents and purposes, this additional base would constitute a "tax" on investment, on a proportion of public consumption and on net exports, while VAT hits private consumption. This new system of financing the Community would be fundamentally GNP-oriented. Depending on changes in the size of the VAT base relative to the additional base, however, the significance of individual GNP components would vary.

A corrective mechanism for the UK is proposed. The UK's claim for compensation is calculated as follows:

$x$ = UK share of Community GNP
$y$ = UK share of EAGGF Guarantee expenditure
$z$ = Aggregate EAGGF Guarantee expenditure

$\frac{1}{2}(x - y)z$ = UK compensation.

The less prosperous Member States (Greece, Ireland, Portugal and Spain) would not have to

[6] COM(87) 101 final, pp 2 ff.

[7] Cf. the Annual Report of the Court of Auditors concerning the financial year 1985, ibid., p. 12.

contribute to the UK compensation. The Federal Republic of Germany would pay only 25%, with the remainder to be contributed by the other Member States in proportion to their relative wealth (shares based on GNP corrected by per capita GNP).

In its submission, the Commission stresses the need for strict budgetary discipline in the next few years and, with a view to this, has repeated its proposal that agricultural expenditure should not increase faster than the own resources base, to be achieved *inter alia* by a restrictive farm price policy. The Commission has furthermore proposed the introduction of automatic stabilizer arrangements, e.g. increased co-responsibility levies and suspension of intervention operations in certain areas above specified production thresholds designed either to cut agricultural expenditure or to raise more revenue from the farming sector.

### Comparison of the Present and Proposed Systems

With regard to increases in non-compulsory expenditure, the Commission recommends that a five year budget planning agreement, valid until 1992, be concluded between the Council, Parliament and the Commission, moving within the own resources ceiling proposed by the Commission.

The following conclusions can be drawn from Table 5:

☐ In the first year of application, the new Commission proposal would bring about a clear reduction in the budgetary burden for the UK and a significant relative increase for Denmark, Italy and Belgium, with more modest increases for the Netherlands and the Federal Republic of Germany.

☐ Since the proportion of funding accounted for by the additional base would rise to over 40% by 1992, the relative budgetary burden for Denmark, Belgium, Italy and the Netherlands in particular should increase, while there should be a relative decline for the UK and Ireland.

☐ Comparison with GDP per capita figures demonstrates that under both the present and proposed systems there is some correlation between the contribution of a Member State and its economic performance.

☐ The proposed system would create an anomalous situation for the UK, however, in that despite a per capita GDP above the Community average its per capita payments would be below average. This state of affairs could only be justified in terms of budget expenditure. As is well known, the UK receives a relatively low volume of expenditure under the Common Agricultural Policy. By reorganizing the system of revenue, the Commission proposes to reduce the scale of the UK anomaly.

The Commission has attempted to combine budgetary reform and own resources proposals in an overall strategy based on the objectives set out in the Single European Act, such as completion of the internal market, promotion of economic and social cohesion and consolidation of research and technology policy.

Nevertheless, initial examination of the proposals as a whole reveals that the Commission has avoided taking a definite position on a vital issue. Logically, under the Commission's approach, the question of the impact of the completion of the internal market on redistributive policy and on growth should be answered. Only after clarification of this fundamental issue can criteria be deduced for establishing the level of funding which will be required to promote, as agreed, economic and social cohesion in the Community *inter alia* by means of

**Table 5**

**Comparison of the Present and Proposed System of Financing**

(1987 Budget – Provisional Estimates)

| | B | DK | D | GR | E | F | IRL | I | L | NL | P | UK | E/12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **I. PRESENT SYSTEM** | | | | | | | | | | | | | |
| Traditional own resources (in m ECU) | 784 | 255 | 2808 | 123 | 1107 | 1533 | 170 | 1259 | 5 | 976 | 158 | 2338 | 11515 |
| VAT (uniform base) (in m ECU) | 770 | 528 | 6878 | 300 | 1704 | 5158 | 196 | 3546 | 63 | 1233 | 186 | 4322 | 24885 |
| Total (in m ECU) | 1554 | 783 | 9686 | 423 | 2810 | 6692 | 366 | 4806 | 68 | 2209 | 344 | 6660 | 36400 |
| Per capita total (in ECU) | 157.7 | 153.2 | 159.4 | 42.0 | 73.2 | 121.0 | 102.2 | 84.2 | 185.8 | 152.0 | 34.1 | 117.8 | 113.2 |
| Per capital total: index | 139.3 | 135.4 | 140.8 | 37.1 | 64.7 | 106.9 | 90.3 | 74.4 | 163.9 | 134.3 | 30.1 | 104.1 | 100 |
| **II. PROPOSED SYSTEM** | | | | | | | | | | | | | |
| Traditional own resources (in m ECU) | 784 | 255 | 2808 | 123 | 1107 | 1533 | 170 | 1259 | 5 | 576 | 158 | 2338 | 11515 |
| ECSC duties (in m ECU) | 7 | 15 | 74 | 3 | 4 | 14 | 1 | 29 | 0 | 9 | 4 | 20 | 180 |
| Actual VAT (in m ECU) | 563 | 386 | 5025 | 220 | 1244 | 3768 | 143 | 2591 | 46 | 901 | 136 | 3158 | 18179 |
| Additional base (in m ECU) | 246 | 172 | 1837 | 70 | 450 | 1354 | 31 | 1114 | 11 | 341 | 62 | 838 | 6526 |
| Total (in m ECU) | 1600 | 827 | 9743 | 415 | 2806 | 6670 | 345 | 4993 | 62 | 2227 | 359 | 6354 | 36400 |
| Per capita total (in ECU) | 162.4 | 161.8 | 160.3 | 41.2 | 73.1 | 120.6 | 96.3 | 87.5 | 169.4 | 153.2 | 35.6 | 112.4 | 113.2 |
| Per capita total: index | 143.5 | 143.0 | 141.6 | 36.4 | 64.6 | 106.6 | 85.1 | 77.3 | 149.7 | 135.4 | 31.4 | 99.3 | 100 |
| DIFFERENCE (II-I) (in m ECU) | 46 | 44 | 57 | –8 | –5 | –22 | –21 | 188 | –6 | 18 | 15 | –306 | 0 |
| **III. Further INFORMATION** | | | | | | | | | | | | | |
| Per capita GDP assuming purchasing power parity (Community average = 100) | 103.9 | 118.6 | 119.3 | 55.0 | 74.5 | 109.8 | 67.6 | 93.7 | 140.6 | 108.7 | 52.4 | 107.5 | 100 |
| Effective VAT, per capita total (in ECU) | 57.1 | 75.5 | 82.7 | 21.8 | 32.4 | 68.1 | 39.9 | 45.4 | 125.7 | 62.0 | 13.5 | 55.9 | 56.5 |
| Effective VAT, per capita total: index | 101.0 | 133.5 | 146.3 | 38.6 | 57.3 | 120.4 | 70.6 | 80.3 | 222.4 | 109.7 | 23.9 | 98.9 | 100 |
| Additional base, per capital total: (in ECU) | 25.0 | 33.6 | 30.23 | 6.9 | 11.7 | 24.5 | 8.6 | 19.5 | 30.1 | 23.5 | 6.1 | 14.8 | 20.29 |
| Additional base, per capita total: index | 123.2 | 165.6 | 149.0 | 34.0 | 57.7 | 120.7 | 42.4 | 96.1 | 148.3 | 115.8 | 30.1 | 72.9 | 100 |

Source: COM(87) 101 final and own calculations.

**Table 6**

**Reduction in UK Budgetary Burden**

1987 budget – provisional estimates

(in m ECU)

| | B | DK | D | GR | E | F | IRL | I | L | NL | P | UK |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Present system | –69 | –49 | –351 | –31 | –165 | –482 | –20 | –331 | –6 | –109 | –19 | +1633 |
| New system | –61 | –49 | –141 | 0 | 0 | –405 | 0 | –261 | –6 | – 93 | 0 | +1016 |

Source: Commission.

regional, social and agricultural structural policy measures. The Commission has avoided an explicit statement, but by specifying figures in its proposals on the budget and on financial requirements, it has implicitly taken a decision.

It is still unclear how, under this budgetary approach, new initiatives pursuant to the Single European Act can be financed, since the Commission's medium-term financial planning makes no distinction between expenditure to honour outstanding commitments and expenditure on new measures.

The Commission repeats its conclusion – and this is undoubtedly correct – that the balance between a Member State's contribution to the Community budget and Community budget expenditure in that Member State cannot be taken as a yard-stick for assessing the benefit it derives from membership. Nevertheless, the Commission has devised a system of financing marked by a book-keeping mentality of net balances. The Commission proposed a complicated accounting system to accommodate those Member States in particular which are especially hostile to proposals to provide the Community with additional resources. Only political considerations can account for the dual compensatory arrangements for the UK: not only has a new own resources system been proposed under which the UK budgetary burden would decline – a major difference vis-à-vis the current system – but the UK would also be guaranteed an additional corrective mechanism.

By again proposing special compensation for the UK, the Commission has finally dropped its call for budgetary imbalances to be resolved via budget expenditure policy. The introduction to the Fontainebleau agreement, in pursuance of which the current compensatory arrangements for the UK were introduced, was as follows: "Expenditure policy is ultimately the essential means of resolving the question of budgetary imbalances."[8] In dropping this demand, the Commission has admitted that, in its view, such a radical reform of agricultural policy is not possible and that there could consequently be major changes in the UK's position as a net contributor, the principal cause of which is the Common Agricultural Policy.

To all intents and purposes, the new system of financing would mean abandoning the notion of conferring power of taxation upon the Community. Compared with the objectives relating to integration defined by Parliament in the draft Treaty establishing the European Union, which explicitly calls for power of taxation to be conferred upon the Community, the Commission's proposals constitute a retrograde step.[9]

## Some Practical Benefits

There is no denying, however, that the Commission proposals contain some practical benefits: it would be easier to calculate revenue ceilings on the basis of GNP; there are recognized definitions of GNP, and national statistics are sufficiently comparable for calculating this value. The harmonized VAT base is more difficult to calculate, however, while, despite scrutiny by the Commission and the Court of Auditors, VAT data are probably less reliable and less easy to compare from Member State to Member State than GNP data.

Introduction of an additional base would put an end to the excessive dependence of Community revenue on private consumption trends and enable financial requirements to be established more easily and on a more stable basis.

The proposals for the control of agricultural expenditure by means of automatic stabilizers are a particularly interesting feature of the Commission's submission. In the light of discussions thus far, however, and pending detailed proposals, no assessment can be made of the effectiveness of the measures. The difficulties faced by the Commission, in Council, with regard to its proposals for the temporary suspension of intervention operations, as well as the opposition to its farm price proposals, demonstrates that there is considerable political resistance in this regard.

Controlling agricultural expenditure is at the heart of any reform of the Community budget, however. The projected development of the Community calls for an end to the crowding-out of non-compulsory expenditure by agricultural expenditure. In a study on Community financial policy, the Centre for European Policy Studies has therefore put forward the radical proposal of disconnecting agricultural expenditure from the Community budget and financing it from separate revenue, in order to secure the development of other Community policy areas.[10]

In its proposals, the Commission has elected not to espouse such radical solutions. Whether its pragmatic approach, which is geared to the politically feasible rather than the needs of integration, is rewarded by the Member States' governments remains to be seen.

[8] Bull. EC 6 – 1984, p. 10.

[9] Cf. the draft Treaty establishing the European Union, which was adopted by Parliament on 14th February 1984; Bull. EC 2 – 1984, pp. 108 ff. and OJ No. C 77, 19. 3. 1984.

[10] "The Future of Community Finance", CEPS Papers No. 30, Brussels.