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EU transfers and the next financial framework

Miklós SOMAI*

Abstract

The main aim of the paper is to display and analyse both the revenue and the expenditure side of the future budget which came to light in the Commission proposal concerning the EU new Multiannual Financial Framework (MFF) of 2014-2020. Efforts were also made to clarify the interests lying behind claims and different behaviour of the member states vis-à-vis the common European budget. All available EU documents on MFF were exploited, especially those published concerning the Commission proposal at the end of June 2011. As a very interesting observation, it was revealed that the Commission proposal rather favours the old and/or developed member states than the new and/or underdeveloped ones. Considering the amount of efforts needed to surmount the crisis and to stabilise public finances, considering in addition the weakening propensity of net contributors to the budget (especially that of Germany) to place EU-cooperation before their own national interests, it is to be feared that the next MFF will not be the one to accelerate the catching-up process of the less developed regions of Europe.

Keywords: EU-budget, Multiannual financial framework (MFF), Common agricultural policy (CAP), Cohesion policy, net position, own resources, British rebate

JEL-classification: F15

1. Introduction

The European Commission put forward its proposal concerning the EU new Multiannual Financial Framework (herein after referred to as MFF) for the seven year period of 2014-2020 at the end of the Hungarian presidency, in the evening of June 29, 2011. Introducing the proposal in such notoriously debatable and divisive issue as the EU budget so close to the summer holiday was perhaps not quite unintentional, as the Commission could expect to attract less attention, but severe criticism and harsh reactions did not take long to emerge.

* Miklós Somai is senior research fellow at The Institute for World Economics of the Hungarian Academy of Sciences, Budapest, Hungary; e-mail: somaimiklos@vki.hu.

Following a short historical background, containing a couple of words on the size of the would-be MFF, I shall try to display and analyse both the revenue and the expenditure side of the proposed budget, which will constitute the two main chapters of this paper. I shall also try to clarify the interests lying behind claims and different behaviour of the member states, with special focus on those of the new ones on one side, and the most powerful ones, like Germany, France and the United Kingdom, on the other.

When preparing this article I exploited all available EU documents on MFF, especially those published about the Commission proposal at the end of June 2011. I also made good use of such valuable volumes as Szemlér's book dealing with the expectations of new member states for the next MFF (Szemlér, 2010), another one, edited again by Szemlér but this time together with Eriksson, mapping the positions of a couple of old and new members on the same topic (Szemlér and Eriksson, 2008), as well as studies by Zerka (2011), Begg (2010) or Brehon (2010). I could certainly not ignore either the hot reactions of member states representatives on the Commission proposal or the harmonised positions of some net contributors to the EU budget.

2. Historical background

Unlike in the periods preceding the Commission's preparation and unveiling of proposals for the forthcoming MFFs, for the last one and a half year, there were almost no or very few clues as to what the current proposal would contain. Only one thing was fairly sure: that, as stipulated by the Lisbon Treaty, the next MFF should not be shorter than five years. Under these circumstances one could not but rely on some official papers reflecting the opinion of the European bodies and decision-makers.

The first such paper was the Commission's document called Europe 2020, published in early March 2010, in which all targets and initiatives were set out with the aim of fighting against poverty, unemployment, premature school-leaving, climate change and fostering knowledge based economy, but in which the word "cohesion" was mentioned only twice, and the expression "common agricultural policy" not at all.[69]

Only a couple of weeks later, a second clue was provided by the so-called "Conclusions" of the European Council (EC) pursuant to its meeting held on 25-26 March 2010 in Brussels.[70] In stark contrast to the overall mood of the above-mentioned Commission's paper, the EC document stood up for both the cohesion and the common agricultural policy (CAP), declaring them necessary for the support of the new strategy (i.e. the Europe 2020 Strategy).

As a third official paper, one can mention the Commission's Budget Review published, after several years of procrastination, in the middle of

[69] See European Commission, 2010a.
[70] See European Council, 2010.

October 2010.[71] The reasons for successive postponement were manifold – delays in institutional reforms, outburst of the financial and economic crisis and of the debt crisis in the Euro Zone – all pushing the Commission to defer the publication of its review to an ever later date, in order to spare member states from having to deal with such an undoubtedly sensitive and contentious topic as the EU budget at a time when unity was a must. As a matter of fact, the Budget Review came too late and was too general in its recommendations, repeating only well-known ideas in an actualised context (e.g. simplification and modernisation of the common budget, as well as bringing it closer to the citizens), but all this interested no one but the European Parliament. Everyone else was looking forward the Commission proposal for the new MFF, finally tabled, as already mentioned, at the end of June 2011.

As a reflection of how important for the member states the whole issue was, in December 2010, leaders of five net contributors to the budget (France, Germany, the UK, Finland and the Netherlands) wrote a common letter to the Commission President, José Manuel Barroso, in which they insisted on the fact that the increase of the EU expenditure had to come to a halt.[72] Precisely, they warned that appropriations for payments should not increase more rapidly than annual inflation and those for commitments should not exceed the level foreseen for 2013, adjusted with less than annual inflation for the whole MFF to come.[73]

Finally, just a couple of weeks before the Commission proposal was due to come out, the European Parliament (EP) issued a challenge to those member states who wanted to freeze the MFF. On the basis of a special committee report, the EP worked out a resolution – which was adopted on 8 June 2011 by 468 votes to 134, with 54 abstentions – calling for an increase by at least 5 per cent in the next MFF in order to complete the objectives and policies agreed for the EU 2020 Strategy.[74]

When the paper “Budget for Europe 2020” came to light[75], it seemed that the Commission had mostly taken into account the views of the EP, as in its proposal for MFF 2014-2020, the total EU spending would rise to €972 billion in payments, with €1,025 billion pledged in commitments, both representing, in real terms, an increase of exactly 5 per cent over the previous period. But if these figures were measured in terms of Gross National Income (GNI), there would practically be no change, for with current MFF (2007-2013), which had been

[71] See Commission, 2010b.
[72] See British Embassy, Paris, 2010.
[73] It is to remember that a similar case had happened in December 2003, a couple of months before the Commission was to present its proposal on the current MFF (that of 2007-2013), when six EU member countries had made a strong statement for limiting the expenditure side of the budget in a mere one per cent of total European GNI (BBC News, 2003).
[74] See: European Parliament, 2011.
[75] See Commission, 2011a.

decided upon in late 2005[76], appropriations for commitments represent 1.045 per cent and those for payments 0.99 percent of total EU GNI, while the respective figures of the proposal for MFF 2014-2020 are 1.05 and 1.00 per cent.

Nevertheless, it is also true that that part of the EU expenditure which is outside the common budget has been augmented by a tiny extra expenditure representing a mere 0.0124 per cent of the EU GNI. This extra spending stems from two sources: from taking some of the existing programs where the costs are too large to be borne only by the EU budget like ITER[77] and GMES[78] out of, and from introducing a new instrument to react to crisis situations in agriculture outside the MFF.

Together with some other headings – responding to crises and emergencies (like the Emergency Aid Reserve, the European Globalisation Fund, the Solidarity Fund and the Flexibility Instrument) representing 0.016 per cent of the EU GNI, or having always been financed outside the budget (like the European Development Fund) representing another 0.031 per cent – the total figure for potential EU spending would rise to a yearly 1.06 per cent for payments and 1.11 per cent for commitments.

The above changes would be too significant for those striving to bring public finances under control, and quite disappointing for those looking forward to a budget being more in line with goals of the Europe 2020 Strategy. Presently, the former group seems to be the one better organised. On 12 September 2011, as a first move of co-ordinated response to Commission proposal, the governments of eight member states (those of France, Germany, Austria, Finland, Italy, Sweden, the UK and the Netherlands) issued a common statement in which they considered the planned expenditure to be too high in a time when many EU members had to undertake serious austerity measures.[79]

To overcome such a discontentment will not be an easy task for the Commission who keeps saying that the increase is not that high if one also takes changes on the revenue side into account.

3. The revenue side of the MFF

According to Article 269 of the EU Treaty, the common "budget shall be financed wholly from own resources"[80]. From the early 1970s, Brussels collected own resources originating from common policies (like customs or agricultural policy) completed if necessary by a standard percentage levied on

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[76] See Council, 2005.

[77] International Thermonuclear Experimental Reactor (a scientific program aiming to demonstrate that it is possible to produce commercial energy from fusion).

[78] Global Monitoring for Environment and Security (a European program for the establishment of a European capacity for Earth observation).

[79] See The Wall Street Journal, 2011.

[80] See Official Journal of the EU, 2006.

the harmonised VAT base of each member state. From the early 1990s, however, the autonomy of these resources has been gradually undermined by the return to the method in use at the beginning of the European integration process, i.e. to national contributions based more or less on member states affluence, measured today in GNI. Hence, the current structure of the EU budget seems to be closer to that of an intergovernmental organisation than a well-advanced economic integration.

In order to remedy such a situation on the expenditure side of the common budget, the Commission proposes three main novelties:

- the simplification of member state contributions, i.e. the abolition of the current VAT-based resource. Considered to be too complex and requiring too significant an intervention in order to arrive at a harmonised base, its abolition would reduce the administrative burden on member states;
- the introduction of two new own resources:
    - a financial transaction tax (FTT) which, in order to reduce the risk of market disruption, would be imposed at very low rates (e.g. 0.1 per cent for bonds and shares, and 0.01 per cent on derivative products);
    - a new, modernised VAT resource to be applied (e.g. at a rate of 1 per cent) on those goods and services only which are subject to the standard rate in each and every member state;
- the reform of the correction mechanisms:
    - the proposal puts an end to all country-specific corrections (including the most famous one, that of the UK) and replaces them with a new system of lump sum gross reductions on yearly GNI payments for Germany (€2,500 million), Sweden (€350 million), the UK (€3,600 million) and the Netherlands (€1,050 million);
    - the proposal brings back the rate of retention, by way of collection costs, of 25 per cent of the amounts of traditional own resources (almost exclusively customs duties) collected by the member states and considered to be a hidden correction mechanism, to 10 per cent, its level in place until 2000.

By the Commission's calculations, all the above changes – apart from simplifying the contribution and reducing the administrative burden for the member states – should considerably increase the revenue coming from the traditional own resources, the VAT-based resource and the new FTT-resource. All together, these revenues should rise from a yearly €33.8 billion in 2012 to €97.3 billion in 2020, thereby reducing the need for member states to complete the common budget by way of transferring money proportional to their GNI by more than €32 billion.[81] According to the Commission proposal for a Council decision on the own resources system, this would give extra room for manoeuvre to the member states general budgetary consolidation.

[81] See the table on page 6 of Commission 2011b.

When trying to identify the possible responses to the Commission proposal, the following points emerge:

- first, claiming that new taxes would reduce the member states' burdens is a mere smokescreen, as any Euros will first be collected by national governments and then handed over to Brussels, hence no longer available for being spent at home;
- secondly, according to an old principle – already laid down e.g. in Magna Charta – there is *no taxation without representation*. However simple the new VAT-based tax may look, it would be seen as an extra burden and thus, will likely be very unpopular. In addition, by eliminating the current VAT-based resource an essential data for the calculation of the UK rebate would no longer be available which could affect the British approach to the new VAT-resource;
- third, although taxing the financial transactions seems nowadays to be very popular, a unilateral initiative in this field could put big European financial centres (including the City of London) at great risk, thus such a novelty is questionable if not done globally;
- finally, most member countries are against any sort of correction mechanism seen as an obvious manifestation of the so widely condemned "*juste retour*" mentality. Maintaining such mechanisms, even if in a simplified form, may trigger significant protest.

Besides, the British, who managed to get back a yearly average of €5,400 million form the EU budget over the period 2003-2009 – enabling them to maintain their operating net balance in a pretty good situation compared with other developed member states (see Table 1), – for the simple reason this specific mechanism happens to be part of the resources system – have veto power over their own rebate. Having this in mind, they will never agree to reduce their money unless a radical change is made in the first pillar of the common agricultural policy (CAP). The British have always been saying the CAP gives no value for member states money, hence it is deserved to be dismantled, which is the only way London would accept the rebate be removed. But, it seems to be reasonable to examine whether the British are really interested in sacrificing their rebate against the destruction of the CAP. For, in the period 2003-2009, there was an average difference of € 1.77 billion between the CAP net cost for the UK in case of no rebate and the rebate itself, the latter having the bigger numerical value.[82] So, the British would only sacrifice the

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[82] The method is the following:

- first, in order to get the operating expenditure, we diminish the EU total expenditure by the administrative expenditure;
- second, we divide the CAP expenditure by the operating one in order to get the ratio of the CAP expenditure as a percentage of the total (operating) expenditure;

rebate to getting rid of the CAP if they were able to restructure the spending side of the EU budget in a way which would compensate them for at least the lost amount.

With this, we can turn our attention to the spending side of the MFF where the Commission also proposed justifications with the intention to calm those dissatisfied down.

Table 1. Operating budgetary balances (measured in national GNI)

	2003	2004	2005	2006	2007	2008	2009
Belgium	-0.28%	-0.18%	-0.20%	-0.22%	-0.26%	-0.21%	-0.49%
Germany	-0.35%	-0.32%	-0.27%	-0.27%	-0.30%	-0.35%	-0.26%
France	-0.12%	-0.18%	-0.17%	-0.17%	-0.16%	-0.20%	-0.30%
Italy	-0.06%	-0.21%	-0.15%	-0.12%	-0.13%	-0.27%	-0.34%
Netherlands	-0.40%	-0.40%	-0.51%	-0.47%	-0.50%	-0.46%	0.02%
Austria	-0.15%	-0.16%	-0.12%	-0.12%	-0.21%	-0.13%	-0.15%
Sweden	-0.34%	-0.37%	-0.29%	-0.27%	-0.29%	-0.43%	-0.03%
UK	-0.14%	-0.16%	-0.08%	-0.11%	-0.20%	-0.05%	-0.12%

Source: Commission, 2011c

4. The spending side of the MFF

The Commission's opinion is that the increase in MFF funds is not that unacceptable if one considers the following changes:

- the Commission intends to impose an austerity package on its own staff. It would involve getting rid of (i.e. pensioned off or let go when contracts expire) 5 per cent of the officials (circa 2,500 functionaries) over a five year period from 2013 onward. The remaining staff would work longer (40 hours a week instead of the current 37.5), would only be allowed to retire later (at the age of 65 instead of 63) and would see the number of their special holidays disguised as official visits to their home countries reduced from 6 days a year to 2. The complete package could save €1 billion a year;
- with a view to reaching the headline Europe 2020 target of 3 per cent of GDP, €80 billion is proposed to be dedicated to research and development

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- third, we calculate UK adjusted (i.e. with no TOR-revenues included) national contribution to the budget in case of no rebate;
- four, we calculate CAP net balance for the UK in case of no rebate in two steps: first we multiply the ratio of CAP expenditure within the operating budget by the UK's adjusted national contribution in order to get the CAP cost for the UK in case of no rebate, and then we diminish CAP expenditure in the UK by the result;
- finally, we compare the absolute values of both CAP net balance for the UK in case of no rebate to the rebate itself.

within a newly created strategic common framework closely linked to key sectoral policy priorities such as health, food security and bio-economy, energy and climate change. It would in this way be brought together the existing three research and innovation instruments, i.e. the 7th Framework Programme, the Competitiveness and Innovation Framework Programme and the European Institute for Innovation and Technology;

- significant amount of new money, a sum of more than €15 billion, would be spent to strengthen Community programs for education and vocational training;
- in order to provide better access to the internal market and put an end to the isolation of certain economic areas, a new subheading named Connecting Europe Facility would be created with a budget-line of €40 billion, to be supplemented by €10 billion from the Cohesion Fund. This money is intended to fill persistent gaps, remove bottlenecks and ensure cross-border connections in the field of transport, energy and information technology;
- although the original concept of creating specific instruments dedicated to climate and environment was eventually ruled out for fear of creating overlaps with cohesion and agricultural policy, climate-related expenditure can easily amount to about 20 per cent of MFF expenditure. Policy actions of this type will be scattered across the budget and streamlined into all major EU funding instruments.
- When evaluating the Commission's conception of the spending side of the MFF, a very interesting observation emerges: most of the proposed changes favour the old and/or developed member states. For example:
- there is a significant increase of funds for research and education, sectors where the old members have comparative advantages, huge capacity and also a propensity for brain-drain from the new member states;
- as far as the future infrastructural projects falling under the Connecting Europe Facility are concerned, most of the designing and construction capacity happens to be concentrated in the hands of big Western European firms;
- in the case of the old policies, like cohesion and agricultural policy, being more in line with the needs of new and/or underdeveloped members, there is clear decline in real terms of the corresponding funds. In case of the CAP for example, its current two-pillar structure, as well as the nominal value of its subsidies, would be maintained which means in real terms a reduction of circa 12-13 per cent between 2013 and 2020;
- what is more, with the aim of sharpening the focus on results rather than inputs, conditionality would be introduced into programs. Hence, the above mentioned funds would not only be reduced but also more and more conditional on such things as performance or "greening".
    - the most striking example is the possible linkage of 30 per cent of CAP direct payments to the delivery of environmental and climate

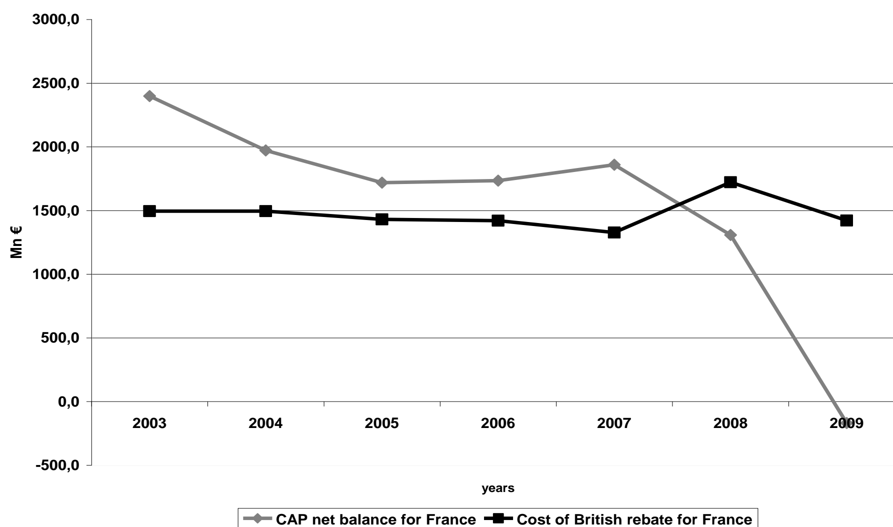
action objectives, well beyond the cross-compliance requirements of the current legislation. It is very easy to imagine that in old member states, where several decades of massive CAP subsidies resulted in a sufficiently high technological level, farmers are closer to being able to satisfy such conditions than those in the new member states;

- the idea of capping the CAP direct payments for the largest agricultural holdings also seems to do more harm to the new than to the old members which is due to the dual structure of the agricultural sector inherited from the communist past. The countries most affected by a future capping are Slovakia, Hungary and the Czech Republic. The only good news within the CAP is the planned progressive adjustment of the levels of direct payments (DPs): all members where DPs are below 90 per cent of the EU-27 average would see the gap between their current level and the mentioned 90 per cent level to be closed by one third by 2020. This convergence would be financed by member states with DPs above EU-27 average;
    - here, I venture a comment on the interests of the two leader countries of the European integration, on those of France and Germany. Let us start with the latter. Although the plan for capping the DPs for the largest agricultural holdings would, especially in the Eastern provinces, affect Germany too, Berlin would no longer accept to be blackmailed or to place the EU-cooperation before its own national interests. For decades, the Germans have not done too much for preventing the regular reproduction of their deficit vis-à-vis the EU-budget, the accumulated amount of which totalled €200 billion between 1981 and 2000. Behind this behaviour one could find political reasons and the fact that in other areas of the European integration, e.g. the single market, they could easily earn back what they lost in the common budget. Since the reunification, however, their motivation for making compromises has gradually weakened. Not only the other relatively well-off old members states but also the new ones have to become familiar with this new stance of Germany and increase their part in the burden sharing within the EU budget;
    - as for France, due to the significant subsidies obtained from the CAP, Paris had for decades enjoyed a privileged position of being only a moderate net contributor: between 1981 and 2000, its average annual deficit was only one sixth of that of Germany. But, this state of grace came to an end with the Agenda 2000. Since 2002 onwards, France has recorded a sharp increase in both its contribution to and its net balance vis-à-vis the common budget. By the end of the current financial framework (2007-2013), France's net position will have been quite comparable with that of Germany[83]. This process has already gone so far

[83] See Brehon, 2010.

that, taking it from a strictly bookkeeping approach, France's annual net benefit out of the CAP is, for the time being, clearly less than its part in the financing of the British rebate (see Graph 1). So, seen from Paris, to dismantle the CAP for the sake of getting rid of the rebate is not an impossible option anymore. Hence, the new member states cannot be certain to get France's support for maintaining a strong European agricultural policy for ever. Under the circumstances of the financial and economic crisis and given the relatively high agricultural and food prices which are expected to last for quite long, the CAP is prone to be cut anyhow;

Graph 1. Net balance of CAP against the cost of the British rebate for France



Source: Commission 2010c, own calculations

- now, after this short digression, let us get back to that observation whereby most of the proposed changes favour the old and/or developed member states. In the cohesion policy, the introduction of a new category of regions, that of "*transition regions*" with GDP per capita between 75 and 90 per cent of the EU-27 average, would replace the current phasing-out and phasing in system. This seems to favour the poorest regions in the old member states rather than the very few rich regions in the new ones. Comparing the support available under cohesion policy for the different categories of region, support for the poorest (the so-called convergence) regions goes from €30.7 billion in 2013 to €24.4 billion in 2020. The same figures for the two other categories are as follows: from €2.0 billion to €5.6 billion for the transition regions and from €6.3 billion to €7.6 billion for the competitive regions.

- o Cutting back the cohesion policy envelope for the relatively poorer regions of Europe is all the more regrettable as cohesion policy has always been a positive-sum game, with beneficial effects both in recipient and net contributor countries. According to researchers' calculation, cohesion projects developed in Poland in the period of 2004-2015 may have important positive externalities, largely compensating for the costs incurred by EU-15. "*Every single euro spent on cohesion in Poland should earn them (i.e. the EU-15) ... around 36 cents back in additional exports of goods and services….Germany turns out to be the biggest beneficiary of Polish cohesion, receiving…72…cents back.*" (Zerka, 2011, p.5) In the long run, beneficial effects may involve an increase of imports stemming from the modernisation of the recipient country's economy and the growing wealth of its citizens;

- finally, the intention of the Commission to concentrate the available money onto the smallest possible number of big projects, claiming that they can deliver higher European added value than scattering the money among a lot of small projects, principally penalizes the smallest and poorest economies (i.e. most of the new member states). Since these projects need to be co-financed from the national budgets, they divert scarce national resources from the development of the still incomplete basic national infrastructure.

5. Conclusions

The Commission will lay out its legislative proposals in detail before the end of 2011. The member states will have time to agree with them by the end of 2012. The European Parliament also has a say: concerning the MFF, the consent of the majority of EP constituent members is required, while for the own resource system only EP consultation is called for.

Considering the amount of efforts needed, at least on the short and medium run, to face and deal with the financial, economic and Euro Zone crisis and to stabilize the public finances, one can hardly believe that enough attention, spirit, energy and determination could be gathered in order for the new Multiannual Financial Framework to be able to answer the real needs of the member states, or to make a substantial contribution to achieving the goals of the Europe 2020 Strategy. It is very likely that the current structure will more or less be preserved, with somewhat less money being made available for the Common Agricultural Policy and hence for the British rebate, and the whole budget will be set at the lowest possible level. It is to be feared that the next MFF will not be the one to accelerate the catching-up process of the less developed regions of Europe.

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