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The EU Financial Perspective 2007-2013 and the forces that shaped the final agreement

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Abstract

In December 2005, the European Council agreed a Financial Perspective for 2007-2013. This reduced significantly planned EU spending compared with the Commission proposal. Moreover, it effectively redistributed net funds from new poorer member states to old richer members. This paper charts the evolution of those budget proposals, with reference to key factors that brought about these changes.

JEL classification: E6, F3, H3

Keywords: EU budget, financial perspectives

1. Introduction

At the Brussels summit meeting of December 2005, the European Council reached agreement on the EU Budget for the period 2007-2013. From the first published Commission proposal, agreement took nearly two years to achieve, but with most debate concentrated in the period between the Luxembourg and Brussels Summits of June and December 2005, respectively. This paper considers the evolution of the proposals tabled in February 2004, until the final agreement in December 2005. Some aspects of the final agreement differed substantially from the Commission's proposals, which had sought to recognise changing economic needs given the 2004 enlargement and international economic concerns arising from ongoing globalisation.

The narrative of this development reveals the complex interplay between institutional rules and substantially-different member state interests in EU budget politics. The key elements of the story presented in this paper are: the negotiation of changes to the UK rebate; the desire of six net contributors to reduce the overall size of the budget, notwithstanding the extra demands for EU spending generated by enlargement; the significance of a 2002 agreement to limit CAP spending through to 2013; and, most important of all (it is argued below), the consequences of the EU budget process being a zero or even negative sum game, given the extant institutional framework and the legacy of previous budget decisions.

EU budget making remains a *locus classicus* of incrementalism in budgetary processes, with the negotiating baseline dominated by concern for spending between member states rather than considerations of the overall net worth or value for money of different items of EU budget expenditure. The first section of the paper details key issues and interests leading up to the negotiation of a new Financial Perspective. From this discussion, some simple principles of the politics of the EU budget process are set out to illuminate the second section of the paper, which details how agreement was reached and presents a critique of its content. One point of particular note is that with the foregoing factors working in concert a redistribution of net funds took place from the initial proposals to the final agreement, from poor to richer member states.

2. Pre-cursors to the Commission's Proposals

The European Commission's first formal proposals for the new Financial Perspective were published in February 2004 (European Commission 2004a). The

second proposal, of July 2004 (European Commission 2004b) altered the numbers only marginally (as described below) and was accompanied by proposals for a fundamental reform of the budget rebate mechanism. Instead of a rebate exclusively for the UK, with abatements on their rebate contributions for four other net contributors[1], the Commission proposed a 'generalised correction mechanism', available to any member state with an excessive net contribution. Continuing to address equity concerns, the timing of the Commission's proposed change was triggered by two basic facts: Since 1980, when the UK first received a rebate on its budget contributions[2], the UK had gone from being one of the poorest member states to one of the richest; whilst successive enlargements, most notably in 2004, brought in more poorer countries - all of whom contributed to the rebate.[3]

The Commission showed that if the total cost of the rebate remained unchanged the UK rebate would halve, with other countries also receiving correcting transfers. The UK rebate could remain the same if the total rebate 'budget' were increased. The Commission's desire to reduce the UK rebate was supported by the other member states. The UK, however, declared that the rebate (by which was meant the extant mechanism) was non-negotiable.

A second challenge to the Commission came two months before the publication of their first proposal. A group of six (G6) net contributors - France, Germany, the Netherlands, Austria, Sweden and the UK - called for the budget to be capped at 1% of GNI (Gross National Income). These countries represented a politically-powerful bloc with the potential to enforce their will on other countries. Their demand did contain a technical ambiguity - did the 1% figure refer to Payment Appropriations or Commitment Appropriations? Payment Appropriations through the 2000-2006 Financial Perspective have fluctuated between 1.07% and 1.11% of GNI, with Commitment Appropriations about 3.5%-4% more, on average.[4]

[1] Germany, the Netherlands, Austria and Sweden.

[2] This date is often given as 1984. In 1984, the formal rebate mechanism was introduced that has operated, with amendments, ever since. Before this, however, four years of *ad hoc* payments were made. See Strasser (1992) pages 166-171 and 369.

[3] In 2004, the ten new member states contributed €293.7 million to the UK rebate, 5.6% of the cost of the rebate (and broadly in line with their share of EU25 GNI). Overall, only 12% of the 2004 rebate was paid by countries richer than the UK (measured by GDP per capita, PPS).

[4] Spending in 2006 is set at 1.08% (see European Commission 2004d).

The letter from the G6 was published on 15 December 2003, just after the Brussels Summit where negotiations on the Constitution had collapsed. Although any link was denied, it has been interpreted as a rebuke to two (current and prospective) net budget recipients, Spain and Poland, whose attitudes were felt by some to have contributed to the collapse of the talks. Although possibly a contributing factor, it is unlikely to have been the sole reason for such a demand. Within the G6, the Netherlands, Sweden and the UK had long sought budgetary restraint. For them, a tight ceiling on spending was a rational way to contain their net transfers. With France and Germany, however, there was the added factor that both had been embarrassed by the European Commission, who had challenged their domestic fiscal deficits under the terms of the Stability and Growth Pact. Demanding cuts in EU spending could reasonably be seen as a political response to this pressure on domestic spending. In common with all public expenditure debates, however, whilst the G6 were able to agree on their desire to cut EU spending in the abstract, they did not agree on how to achieve this in concrete terms, as discussed below.

A third factor, which cast a long shadow over the negotiations, also featured France and Germany. During the October 2002 talks over the terms of the 2004 enlargement, France and Germany obtained an (initially bilateral) agreement limiting CAP spending through to 2013. This arose from a confluence of concerns: opposition (at the time) to further CAP reform under the concurrent 'Mid-Term Review' of the 1999 reform from the countries benefiting most from CAP transfers (notably France, Ireland and Spain); and concern about the impact of EU enlargement on CAP spending, most notably on direct payments to farmers in the new member states.

Agreement was reached, first, that direct payments would be phased in gradually over 10 years. It is alongside this that the limit on CAP spending was agreed. Given its significance for what follows, the relevant paragraph from the Presidency Conclusions (Council of the European Union, 2002: 5) is quoted in full:

> *"The phasing-in will take place within a framework of financial stability, where total annual expenditure for market-related expenditure and direct payments in a union of 25 cannot – in the period 2007-2013 – exceed the amount in real terms of the ceiling of category 1.A [CAP market-related and direct payments expenditures] for the year 2006 agreed in Berlin [ie as laid down in the present*

Financial Perspective] for the EU-15 and the proposed corresponding expenditure ceiling for the new Member States for the year 2006. The overall expenditure in nominal terms for market-related expenditure and direct payments for each year in the period 2007-2013 shall be kept below this 2006 figure increased by 1% per year."

This agreement was supported by the UK (and others) for two principal reasons: it was an integral part of the package setting out the terms for the 2004 enlargement; and it was seen as a way of limiting CAP spending in the context of that enlargement. A further complementary instrument – 'degressivity' – was added as part of the 2003 CAP reform agreement: from 2007, if forecast spending should exceed the spending ceiling by more than €300 million, the Commission shall propose cuts to CAP direct payments to the EU15 (the new member states are excluded as their payments are still being phased-in). The Commission had wanted an automatic cut, but the final agreement was for a Council decision based on a Commission proposal. Recent experiences with the Stability and Growth Pact, however, raise fundamental questions about how successful such a mechanism might be.

This agreement was generally approved of at the time, as it represented a ceiling on CAP spending. Although doubts were expressed about whether the spending limit could accommodate full payments in the new member states (see, *inter alia*, Ackrill, 2003), the agreement on degressivity helped assuage fears. What was not widely seen at the time was the way in which this ceiling on CAP spending would become a floor: whilst it precluded above-inflation rises in CAP spending, this reinterpretation of the text became a device to block cuts in spending as well. As for why countries would wish to do this, discussion moves to the fourth pressure on the negotiations – arguably the most significant of all.[5]

Since 1988, the EU budget has gone from a positive to a zero-sum game. Under the first two Financial Perspectives, the EU spending limit rose, both in absolute terms and as a percentage of GNI.[6] As total spending rose, member states were able to seek larger transfers from the EU budget without this necessarily being at the expense of payments to other member states. Under the 2000-2006 Financial Perspective, however, the own resources ceiling was held at 1.24% of GNI, with

[5] For a detailed analysis of the issues underpinning the following discussion, see Ackrill and Kay, 2006.

[6] At the time, Gross National *Product* was the measure used. Note also that given the presence of a balanced budget rule, this spending limit defines maximum permissible expenditure.

Payment Appropriations also more or less stable (as described above). This turned the EU budget process into a zero-sum game – for one country to gain, another must lose. Given that, a second-best strategy for countries in the negotiations would be to seek to defend existing spending shares.

The current talks, however, sought to reduce both Payment and Commitment Appropriations, thus creating a negative-sum game. It may, however, be hypothesised that countries who have been in the EU longer have more established ('entrenched' may be more accurate) domestic political interests pushing them towards preserving spending shares. The concerns of the new member states may also be mitigated by the knowledge that their receipts will rise automatically up to 2013 as CAP direct payments are phased-in. Indeed, contemporary press reports claimed these countries took the view that most deals would be better than no deal.

Furthermore, even within a zero-sum game it is feasible for 24 countries to gain if one loses. Since the other 24 countries contribute to the UK rebate, they would all gain from its reduction. Having opposed such a change previously, why did the UK not veto any deal including such a cut? A detailed analysis of the politics of negotiation is beyond the scope of this paper. One factor, however, needs highlighting - the UK held the Presidency and would be blamed for failure to reach agreement. In general, the country in the Chair faces considerable political pressure to achieve agreement, if necessary by compromising on pre-Presidency positions and sacrificing some measures of 'national interest'.[7] This gives rise to the old political saying, seen once again in EU negotiations: that it does not matter where you stand on an issue that matters, but where you sit.

Note that the CAP spending agreement, driven by 'old' member states, is consistent with the issues arising from a zero or negative-sum game. If enlargement drove CAP spending beyond the agreed limit, this could force a cost-reducing CAP reform which would hit all member states. The October 2002 agreement, however, effectively ring-fenced EU15 CAP receipts, containing the overall cost of the CAP by phasing-in payments to the new member states. The 2003 degressivity agreement put EU15 CAP receipts back in the spotlight, but by rejecting automatic payment cuts in favour of a Council decision based on a

[7] For example, Ackrill, 2005, identifies three separate CAP reform agreements where the country in the Chair made such a compromise - Germany in 1988 and 1999, Portugal in 1992.

Commission proposal, the member states re-established decision-making authority.

3. The Forces that Shaped the Budget Agreement

As a result of the foregoing discussion, some simple guiding principles can be identified that can frame the following dissection of the final budget agreement - and how the EU got there from the proposals of 2004:

- countries, but in particular the EU15, will seek to preserve their shares of available EU spending;
- the easiest way to do this is by protecting receipts from the main spending policies - the CAP and regional ('convergence') policies;
- cuts, from the proposal, are likely to be concentrated either on new policy measures or on measures whose planned spending levels are significantly higher than before, since such cuts would not affect the prevailing distribution of transfers across countries;
- the UK, in the Chair, will face great pressure to compromise on measures of particular concern to her domestic interests.

4. Evolution of the Proposed Perspective

When European Commission 2004a was published, it challenged the G6 directly. Payment Appropriations would rise from an average of 1.08% over 2000-2006 to 1.14% over 2007-2013. With all ten new member states, plus Bulgaria and Romania (expected to join in 2007) being net budget recipients, aggregate net contributions from the EU15 would rise.[8]

The revised proposal documents of June and December 2005, referred to below by their publication date, were produced by the Council Presidency (Luxembourg and the UK respectively) as a way of framing discussions. These "Negotiating Boxes" were neither "a report on the discussions so far", nor "at this stage.....a global compromise package". They were "rather a tool designed to provide a solid framework and give focus and to the discussions" (Document of 2 June 2005, pages 1-2).[9]

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[8] The only differences between the February and July 2004 proposals were that post-accession compensation (line 6) was, in February, included in line 4, whilst €6.2 billion of spending included in line 1b in February was, in July, moved to line 3 (Table 1 shows the structure of the Perspective).

[9] Details of the Negotiating Box documents drawn upon in this paper are given in the Appendix.

Table 1: Structure of the Financial Perspective 2007-2013

Line	Heading
1	Sustainable Growth
- 1a	Competitiveness for Growth and Employment
- 1b	Cohesion for Growth and Employment
2	Preservation and Management of Natural Resources
- of which	Agriculture – market-related expenditure and direct payments
3	Citizenship, freedom, security and justice
- 3a	Freedom, security and justice
- 3b	Citizenship (also called 'other internal policies)
4	EU as a global player
5	Administration
6	Compensations
	Total Appropriations for Commitments
	Total Appropriations for Payments
	Margin available
	Total own resources ceiling

Notes: Line 3 is not split into 3a and 3b in the Commission proposals. In the final agreement, total Appropriations for Commitment and for Payment are expressed both in absolute terms and as a percentage of GNI.

The discussion that follows charts the progress of the proposals through these Negotiating Boxes. In comparing amounts between the Commission and Council documents, however, there is a discontinuity with spending line 5 "Administration". The Commission allocates its own administration expenditure to each spending line, 1 to 4. In all Council documents, however, Commission administration spending is included in line 5. That said, the sums involved are relatively modest and a comparison of the magnitude of changes across spending lines 1 to 4 remains valid.

Table 2 summarises the evolution of total Commitment Appropriations (CA) and Payment Appropriations (PA). Not shown here, the own resources ceiling on PA was left unchanged throughout, at 1.24% of GNI (1.31% for CA). This oft-quoted figure is, however, somewhat misleading, since PA is actual annual spending, whilst the 1.24% figure includes a margin for unforeseen expenditure. The focus of the discussion, in the EU and here, is on PA and CA. The first point to note is the magnitude of the spending cut in the Luxembourg proposal of 17 June 2005, with CA reduced by over €150 billion (15%) and PA by over €100 billion (10.9%). Despite the depth of cuts proposed, the G6 led the rejection of this proposal as not going far enough. Thus the first proposals from the UK Presidency, of 5 December, sought a further cut, of 2.8% from CA and 2.4% from PA.

Subsequently, two modest reversals left total CA in the final agreement over €160 billion (15.9%) down on the Commission proposal and PA nearly €110 billion (11.8%) down. PA averaged 0.99% of EU GNI whilst CA averaged 1.045%, a clear triumph for the G6. These figures stand in sharp relief to those for 2000-2006. The extent of the reduction agreed means that CA over 2007-2013 will actually be less than PA over 2000-2006, as a percentage of GNI. The margin, instead of averaging 0.10% of GNI, will average an unprecedented 0.25%.

Table 2: The Evolution of Total Commitment and Payment Appropriations, € million and % of EU GNI, 2007-2013

	Date	2007	2008	2009	2010	2011	2012	2013	Total
Total Appropriations	14/07/04	133560	138700	143140	146670	150200	154315	158450	1025035
for Commitments	17/06/05	120043	121455	123176	124287	125421	127455	129677	871514
	05/12/05	118508	119066	120090	120587	121280	122765	124458	846754
	14/12/05	118959	119536	120598	120696	121610	123073	124753	849225
	19/12/05	120601	121307	122362	122752	123641	125055	126646	862364
- as a % of GNI	05/12/05	1.08	1.06	1.04	1.02	1.01	1.00	0.99	av. 1.03
	14/12/05	1.08	1.06	1.05	1.02	1.01	1.00	0.99	av. 1.03
	19/12/05	1.10	1.08	1.06	1.04	1.03	1.02	1.00	av. 1.045
Total Appropriations	14/07/04	124600	136500	127700	126000	132400	138400	143100	928700
for Payments	17/06/05	117205	120315	112888	119170	116896	120669	120371	827514
	05/12/05	115545	118365	110171	116385	113583	116927	116451	807427
	14/12/05	115656	118546	110492	116671	113899	117268	116787	809319
	19/12/05	116650	119535	111830	118080	115595	119070	118620	819380
- as a % of GNI	14/07/04	1.15	1.23	1.12	1.08	1.11	1.14	1.15	
	17/06/05	1.07	1.07	0.98	1.01	0.97	0.98	0.96	av. 1.00
	05/12/05	1.05	1.05	0.96	0.99	0.94	0.95	0.92	av. 0.98
	14/12/05	1.05	1.05	0.96	0.99	0.95	0.95	0.93	av. 0.98
	19/12/05	1.06	1.06	0.97	1.00	0.96	0.97	0.94	av. 0.99

As for the sources of the spending cuts, the analysis that follows first considers line 2 – especially CAP spending. It then considers 1b, (cohesion) before reviewing briefly the remaining, smaller, elements of the Perspective. Table 3 summarises the evolution of spending line 2. Unlike the Financial Perspective, this includes separate figures for the balance of spending other than CAP market-related and direct payment costs. Both Commission proposals and all subsequent Council documents took the 2002 CAP spending agreement as a *de facto* minimum as well as maximum. The apparent 2% cut in CAP spending introduced in the 15 June document is a consequence of the previously-noted changes to the presentation of administration costs. The further 'cut' of €2 billion in the 5 December document is the removal from the Perspective of planned spending in

Bulgaria and Romania. By preserving spending on the most expensive element of the most expensive policy, the member states took a major step towards preserving the existing distribution of total EU spending.

Table 3: The Evolution of Planned Spending on Budget Line 2 "Preservation and Management of Natural Resources", € million, 2007-13

	Date	2007	2008	2009	2010	2011	2012	2013	Total
Total	14/07/04	57180	57900	58115	57980	57850	57825	57805	404655
	15&17/06/05	54502	54483	54421	53916	53630	53483	53366	377801
	05/12/05	54439	53775	53120	52477	51840	51215	50598	367464
	14/12/05	54504	53841	53186	52542	51906	51281	50664	367924
	19/12/05	54972	54308	53652	53021	52386	51761	51145	371245
of which agriculture	14/07/04	43500	43673	43354	43034	42714	42506	42293	301074
(market-related and DPs)	15&17/06/05	43120	42797	42429	42114	41753	41547	41345	295105
	05/12/05-19/12/05	43120	42697	42279	41864	41453	41047	40645	293105
of which the balance	14/07/04	13680	14227	14761	14946	15136	15319	15512	103581
	15&17/06/05	11382	11686	11992	11802	11877	11936	12021	82696
	05/12/05	11319	11078	10841	10613	10387	10168	9953	74359
	14/12/05	11384	11144	10907	10678	10453	10234	10019	74819
	19/12/05	11852	11611	11373	11157	10933	10714	10500	78140

Given the preservation of CAP spending, total spending on line 2 saw the smallest cut from the Commission proposal, 8.3% (including the presentational change to administration spending). With 'traditional' CAP spending ring-fenced, the balance of line 2 (including rural development spending), was cut by nearly 25%, although only the Council documents identified separately the sums within that allocated to rural development. The June 2005 documents converge on a figure of €74.2 billion, but the 5 December document reduces this to €66 billion. Each of the three remaining documents restored some of this cut, but the final agreed figure was still only €69.75 billion. That said, an element of the final agreement introduced in the 5 December document gives member states the option of transferring up to 20% of market-related and direct payment funds into rural development measures. Moreover, this money will not require national co-financing.

The UK documents also identify the minimum amounts of rural development money to be allocated to the new member states, Bulgaria and Romania. The initial, 5 December, figure of €32.6 billion was increased just once, to €33.01 billion. Because the Commission documents did not indicate these figures

separately, the extent of the ring-fencing of EU15 receipts from rural development cannot be identified.

One feature of the final agreement is that from 2008, spending on agriculture (market-related and direct payments) is overtaken by spending on line 1b, giving the impression that the CAP will soon cease to be the most expensive policy. This is, however, an accounting artifice. The (seven-year) total for CAP spending, including rural development from line 2, exceeds that of line 1b by nearly €55 billion.

Table 4 charts the evolution of line 1. Focusing on line 1b, which represents nearly 72% of the line 1 total, this saw the second smallest cut imposed, 9.2%. The 15 June proposal removed over €32 billion (9.5%) from the Commission proposal, whilst the 5 December document removed a further €12.7 billion. After each, however, there was a partial reversal, with the last three December documents restoring nearly 85% of the latter cut. Even so, the final agreement removed about €31.1 billion from the Commission proposal – on money intended for the poorest regions in the EU and, therefore, from the new member states in particular.

Table 4: The Evolution of Planned Spending on Budget Line 1 "Sustainable Growth", € million, 2007-2013

	Date	2007	2008	2009	2010	2011	2012	2013	Total
Sustainable Growth	14/07/04	58735	61875	64895	67350	69795	72865	75950	471465
	15/06/05	50657	51703	52473	53965	55020	56567	58133	378518
	17/06/05	50972	52071	53295	54542	55351	56902	58471	381604
	05/12/05	49530	50540	51690	52580	53330	54840	56400	368910
	14/12/05	49926	50955	52144	52635	53606	55094	56640	371000
	16/12/05	51141	52200	53382	54052	54997	56445	57912	380129
	19/12/05	51090	52148	53330	54001	54945	56384	57841	379739
competitiveness for growth and employment	14/07/04	12105	14390	16680	18965	21250	23540	25825	132755
	02/06/05	8280	8950	9670	10450	11290	12190	13170	74000
	15/06/05-16/12/05	8230	8840	9490	10180	10930	11740	12600	72010
	19/12/05	8250	8860	9510	10200	10950	11750	12600	72120
cohesion for growth and employment	14/07/04	46630	47485	48215	48385	48545	49325	50125	338710
	15/06/05	42427	42863	42983	43785	44090	44827	45533	306508
	17/06/05	42742	43231	43805	44362	44421	45162	45871	309594
	05/12/05	41300	41700	42200	42400	42400	43100	43800	296900
	14/12/05	41696	42115	42654	42455	42676	43354	44040	298990
	16/12/05	42911	43360	43892	43872	44067	44705	45312	308119
	19/12/05	42840	43288	43820	43801	43995	44634	45241	307619

From 2007, EU regional policy is to be re-structured under three new Objectives – Convergence, Regional Competitiveness and Employment, and Territorial Co-operation. The Negotiating Boxes (but, again, not the Commission proposals) also indicate how total spending is to be allocated to these headings. Table 5 summarises this information. With spending on territorial cooperation set low and left unchanged, the focus is between the poor 'Convergence' regions and richer regions where help is targeted at specific economic problems.

Table 5: The Allocation of spending on line 1b, cohesion for growth and employment, between the three objectives of regional policy

Date	Total 1b	Convergence		Competitiveness and Employment		Territorial Cooperation	
	€ billion	€ billion	percent of total 1b	€ billion	percent of total 1b	€ billion	percent of total 1b
15/16/05	306.508	252.249	82.3	46.758	15.26	7.50	2.45
17/06/05	309.594	254.781	82.3	47.313	15.28	7.50	2.42
5/12/05	296.900	242.2	81.6	47.2	15.9	7.50	2.5
14/12/05	298.990	243.984	81.6	47.505	15.9	7.50	2.5
16/12/05	308.119	252.234	81.9	48.386	15.7	7.50	2.4
19/12/05	307.619	251.330	81.7	48.789	15.8	7.50	2.4

Table 5 illustrates the point that in the 'new' budget politics of the EU, recent entrants are the easiest to squeeze in order to reduce planned spending. When, from one proposal to the next, there is a rise (usually marginal) in planned spending on 1b, the extra money is shared between Convergence (the poorest regions) and Competitiveness and Employment (richer regions). On the two occasions when there is a cut in 1b spending, however, the burden falls on the poorest regions. In the 5 December document, there is a small cut in planned Competitiveness and Employment spending but, in the final agreement, the cut imposed on Convergence spending is accompanied by an increase in Competitiveness and Employment spending.

Overall, from 15 June to the final agreement, there has been a relative and absolute transfer of resources from poor to richer within the EU. Such a finding is contrary to the meaning of "cohesion", but this is tempered by the relatively very small sums involved. It is, however, consistent with the earlier observation that countries, especially the EU15, will seek to preserve their transfers from the EU budget. It also explains the accusation levelled at Tony Blair during the closing stages of the talks that, by taking funds from the new member states in

particular, he was acting like Robin Hood in reverse, taking from the poor to give to the rich.

Further, the Council documents identify the share of Competitiveness and Employment money to be allocated to "phasing-in" regions – those whose natural economic growth (rather than the "statistical effect" described below) has left them ineligible for Convergence spending. They also identify the shares of Convergence money to be allocated to the Cohesion Fund and to "phasing-out" regions – those who will lose eligibility to payments, because of the "statistical effect" – the fact that enlargement from 15 to 25 countries lowered the average income level in the EU, moving some countries and regions above one of the EU eligibility thresholds[10].

Within the expanded budget for Competitiveness and Employment, there was a relative and absolute increase in funding (nearly €1 billion) for "phasing-in" regions. Within the (reduced) budget for Convergence regions, sums assigned to the Cohesion Fund fell slightly (by €435 million over seven years), whilst sums assigned to "phasing-out" regions, by definition the richest of the Convergence regions (principally) in the EU15, rose by just over €300 million. Planned spending on general Convergence measures in the poorest regions thus fell by about €800 million, (albeit less than 0.5% in relative terms). These figures confirm funding shifts in favour of richer regions and those in the EU15. In effect, money has followed countries from the first to second objective as they have grown richer whilst, even within the first (Convergence) objective, there has been a reduction in spending assigned to the poorest member states. Again, however, the (relatively) very small sums involved must be emphasised.

The Negotiating Boxes contain extensive discussion on the precise allocation of line 1 spending (an indication of the extra complexity the new Financial Perspective has introduced). One point will be discussed here, as it relates to one of the principal themes of this paper. Currently, transfers to any member state under regional policy (including the Cohesion Fund) cannot exceed 4% of national Gross Domestic Product (GDP). This has now been reduced, as summarised in Table 6, again shifting funds away from the poorest member states. The maximum that the poorest member states can receive is just under 3.8%, whilst the richer Convergence regions lose out by even more. The biggest cut in planned 1b spending, from 15 June, introduces a tapered ceiling, but from 4%. It is the

[10] 75% of the EU average for general Convergence funds, 90% for the Cohesion Fund.

UK that proposed a cut in the 4% figure, albeit with a more gradual taper, with the 16 December document offering only a partial reversal of the initial cut. Note, moreover, that this reduced limit on total 1b transfers now also includes rural development and fisheries spending.

Table 6: The Maximum Rates of Transfer to Individual Member States under the Cohesion Objective, % of national GDP (EU25=100%)+

Date	<40%	40%+, <50%*	50%+, <55%	55%+, <60%	60%+, <65%	65%+, <70%	70%+, <75%	see notes
2&15/06/05	4%	3.9%	3.8%	3.7%	3.6%	3.5%	3.4%	a
17/06/05	4%	3.92%	3.82%	3.72%	3.62%	3.52%	3.42%	a
5&14/12/05	3.663%	3.590%	3.498%	3.407%	3.315%	3.223%	3.132%	b
16&19/12/05	3.7893%	3.7135%	3.6188%	3.5240%	3.4293%	3.3346%	3.2398%	b

Notes: + Measured as GNI per capita (PPS), average over the period 2001-2003.
* This should be read as "forty percent or above, but less than fifty percent", etc.
a Thereafter, the spending ceiling is reduced by 0.1 percentage points for every 5 percentage point band of GNI per capita.
b Thereafter, the spending ceiling is reduced by 0.09 percentage points for every 5 percentage point band of GNI per capita.

One of the arguments offered for lower cohesion payments to the new member states, enshrined in the final agreement (paragraph 20, page 9), was that cuts were made "in order to pay regard to the finite capacity of Member States to utilise effectively the resources available". This cut was the option chosen by the (rich EU15) member states in preference to providing assistance improving this capacity, or reducing the complexity of the implementing rules. It is, however, interesting to note that **exactly** the same wording appears in the document of 2 June (paragraph 15, page 8), but in that case justifying the prevailing flat-rate ceiling of 4%. This raises serious questions about the underlying motive for the reduced spending ceiling. Relative to richer EU countries, giving poorer (and newer) countries less because of capacity and utilisation constraints is, once again, a response consistent with the richer countries acting to preserve their shares of available EU spending.[11]

It has long-been the case that 80%-90% of total EU spending has gone on the CAP and regional policy. Translating these (broadly) to lines 1b and 2 of the

[11] This is also seen in the calculation determining the financial envelopes for Convergence Regions. Between 2 June and 19 December, the coefficient used in this calculation is raised from 4.2% to 4.25% for regions with GNI per capita below 82% of the EU average. For regions at or above 100% of average wealth, however, it is increased from 2.52% to 2.67% (for intermediate regions, the coefficient is unchanged at 3.36%).

budget for 2007-2013, they will take about 84% of total Payment Appropriations in 2007, falling to about 81% in 2013. The February 2004 proposals had these representing 84% in 2007, but 'just' 76% in 2013 (the corresponding figures for the July proposal are 83.3% and 75.4%). Whilst the Commission proposals represented a marginally altered balance of spending, it cannot be said those proposals constituted a radical refocusing of the EU budget: and by a similar token, therefore, neither can the European Council's subsequent changes be considered an anti-radical retrenchment.

Given, therefore, the limited changes agreed for lines 1b and 2 (and with the prevailing distribution of EU spending shares preserved), the percentage cuts imposed on the remaining spending lines by the final agreement must have been considerable. The largest absolute cut was imposed on what was to be – and remains – the third largest element: 1a "competitiveness for growth and employment". Nearly €60 billion (44.3%) was cut in the 2 June document, with a further €2 billion cut in the 15 June document. The final agreement restored just €110 million of this, giving a final figure 45.7% below the Commission proposal.[12]

A comparable (percentage) cut was also imposed on line 4 "the EU as a global partner". The 2 June document removed over €44 billion (46.5%) and the 15 June document cut a further €1 billion. No further cuts were imposed, leaving the final agreed figure 47.6% below the Commission proposal. Nearly half of this cut however, (€22.682 billion, in current prices) was achieved by the simple expedient of reversing a Commission proposal to incorporate into the EU budget, spending that currently lies outside of it: support for cooperation with the African, Caribbean and Pacific countries through the inter-governmental European Development Fund.

Line 3 saw the largest percentage cut. The 2 June document removed €12.7 billion of spending (51.6%). Two further cuts, one from Luxembourg, one from the UK, saw the final figure €14.4 billion (58.4%) below the Commission proposal, split more or less evenly across lines 3a and 3b.[13] The changes made to

[12] The European Council also approved the establishment of a Globalisation Adjustment Fund, to support "workers made redundant as a result of major structural changes in world trade patterns" (paragraph 12, page 6 of the final agreement). No specific financial provision is made for this measure. It will instead be funded from money made available either as a result of Commitment Appropriations underspend and/or de-committed money.

[13] The other change is the larger 'Compensation' figure in the Luxembourg and UK documents. This is accounted for by the approval, in October 2004, of Romania's accession and inclusion of their receipts.

these other spending lines, summarised in Table 7, are consistent with *a priori* expectations about where cuts would come. Countries motivated by a desire both to preserve spending shares whilst seeking a smaller overall budget will concentrate, as seen above, on preserving the main spending lines (1b and 2) whilst, if necessary, reducing the spending going to the poorest countries, who are principally the new member states. Targeting cuts on spending lines that are either new or newly-expanded will also leave prevailing spending shares unaffected.

Table 7: The Evolution of Planned Spending on Budget Lines 3 "Citizenship, freedom, security and justice" and 4 "the EU as a global partner", € million, 2007-2013

	Date	2007	2008	2009	2010	2011	2012	2013	Total
Citizenship, freedom, security and justice	14/07/04	2570	2935	3235	3530	3835	4145	4455	24705
	02/06/05	1170	1300	1460	1650	1860	2110	2410	11960
	15&17/06/05	1150	1260	1390	1530	1700	1880	2090	11000
	05-19/12/05	1120	1210	1310	1430	1570	1720	1910	10270
Freedom, Security and Justice	02/06/05	620	720	850	1010	1190	1410	1670	7470
	15/06/05-19/12/05	600	690	790	910	1050	1200	1390	6630
Other internal policies	02/06/05	550	580	610	640	670	700	740	4490
	15&17/06/05	550	570	600	620	650	680	700	4370
	05/12/05-19/12/05	520	520	520	520	520	520	520	3640
The EU as a global partner	14/07/04	11280	12115	12885	13720	14495	15115	15740	95350
	02/06/05	6310	6610	6930	7260	7600	7960	8340	51010
	15/06/05-19/12/05	6280	6550	6830	7120	7420	7740	8070	50010

The much-enlarged budget for line 1a had been motivated by a desire to drive forward the Lisbon Agenda. Given the constraints imposed on the negotiations endogenously by the member states this line, constituting new spending for non-traditional EU activities, was always going to be vulnerable (a cynic might add that given some member states' failure to undertake competitiveness-oriented reforms domestically, they would not then agree to greater EU spending on such measures). That said, the UK documents targeted more explicitly 1b spending towards measures supporting the Lisbon Agenda (albeit within the lower spending limit for 1b). Moreover, from the 17 June document there was text added (paragraph 11, page 6 in the final agreement) calling on the Commission and European Investment Bank to examine the possibility of introducing "a financing

facility with risk-sharing components" to make up to €10 billion available for research and development, in particular to the private sector. This is, however, money that is borrowed and it lies outside the EU Budget framework.

The final point to consider is the extent to which the UK, as President and Chair, had to compromise on its prior stated position in order to achieve agreement. The focus is on the specifics of the budget rebate, although it will also have been responsible for preparing the December compromise documents, in the light on ongoing negotiations with the other countries. On this later point, however, the lower overall spending limit was consistent with the UK position within the G6, whereas it was on the rebate that 'national interest' was under greatest pressure.

The Commission document of February 2004 expressed the intention to introduce a generalised correction mechanism, proposed in July 2004. By June 2005, however, the UK had ensured this was no longer on the agenda. The 1984 ('Fontainebleau') mechanism was to be retained, but the amount reimbursed to the UK adjusted, in the light of the CAP now taking a lower share of EU spending, more cohesion expenditure following successive enlargements and the rise in the UKs relative wealth. Specific adjustments should be retained for Germany, the Netherlands and Sweden, maintaining the abatement on their contributions to the UK rebate (Austria is mentioned explicitly only from the 5 December document).

The UK, under growing pressure, attempted to link changes to the rebate with 'fundamental' CAP reform. Whilst, arguably, fundamental CAP reform had occurred in 1992 and 2003, no CAP reform had ever succeeded in cutting spending. The response from the likes of France (the largest beneficiary from CAP spending) and Ireland (receiving the largest per capita transfers) was, as already seen, to use the 2002 agreement as a means of keeping CAP spending off the table.

The 2 June proposal was for a rebate in 2007 equal to the average over the period 1997-2003, declining thereafter. The following documents, however, made significant additions to the basic proposal. The 15 June proposal argued that the rebate after 2013 would depend on how CAP spending developed, and that "budgetary imbalances should ultimately be resolved through expenditure policy" (paragraph 71, page 23). The Commission should also present a review of own resources in 2011.

The 17 June document introduced further crucial changes (paragraph 69, page 7). The link was made explicitly between the rebate and the costs of enlargement, the burden of which should be "fairly shared between all Member States". The rebate was also now linked to the net budget position of other member states, to ensure the UKs "net balance expressed as a percentage of GNI [is] comparable to those of similar Member States which do not benefit from a budgetary correction". Moreover, paragraph 70(b) excluded from the rebate calculation spending in the new member states, other than CAP market-related and direct payment costs. The Commission review of own resources, now brought forward to 2010, should also consider developments in the structure of spending and the findings of the review of the 2003 CAP reform.

The first UK document, of 5 December, proposed two alternative mechanisms for reducing the rebate. One was similar to the previous suggestion, but excluded from the rebate calculation just "x%" of the cost of cohesion measures in the new member states. The other was to redistribute funds equivalent to a VAT call-up rate of 0.115% through the GNI-based own resource payment: the UK paying more, the other member states paying less, in proportion to their contributions to the UK rebate. The UK also built on the Luxembourg proposals by calling for a comprehensive review of all aspects of the EU Budget "including, *inter alia*, the Common Agricultural Policy, and the UK rebate" (paragraph 81) in 2008.

The final agreement returned to earlier proposals, in that the rebate calculation should exclude not only cohesion spending in the new member states, but all spending other than CAP market-related and direct payment costs. The extent of the exclusion shall, however, be scaled, so that by 2011 all non-CAP spending is included. The total cut in the UK rebate will be (no higher than) €10.5 billion compared with a continuation of the current system (paragraph 78(d), page 30).[14] Within days, however, a potential future flash-point arose as calculations suggested that despite the €10.5 billion figure being stated explicitly, the other elements of the agreement would see the annual rebate cut not by €1.5 billion but €2.8 billion.

The UK thus had to concede ground on the rebate. It had not got a matching CAP reform, only a future review of the CAP alongside a review of the (now smaller)

[14] Previously, the UK had wanted a limit of €8 billion.

rebate[15] – although in subsequent interviews, UK Ministers claimed this was all they had sought. Under pressure domestically for reducing the rebate without obtaining a CAP reform, the UK government emphasised the link between the rebate cut and the national gains to be had from additional UK exports to the new member states as they develop, with help from EU cohesion spending. Not for the first time, these talks showed that despite its tiny economic size, the EU budget carries great political weight, consisting as it does of the balancing of (now) 25 **national** interests.

5. Concluding Comments

In December 2005, the member states agreed a Financial Perspective for 2007-2013. This paper has examined how a number of key factors helped shape those talks, from the Commission's proposals to the final agreement. These factors were that countries, especially the EU15, would seek to preserve their shares of EU spending; that the easiest way to do this would be to protect receipts from (and thus minimise change to) the main spending policies – the CAP and regional policies; that cuts would be concentrated either on new policy measures or on measures whose planned spending levels were raised significantly in the Perspective from 2007 (since these cuts would not affect the prevailing distribution of transfers across countries); and that the UK, as President and Chair of the meetings in December 2005, would face pressure to compromise on measures of particular concern to her domestic interests.

It has been argued that the first of these factors was the most significant, but was supplemented by other pressures. The 2002 agreement to CAP spending has been reinterpreted so that the maximum level of future spending is now also seen as a minimum – a move consistent with the defence of spending shares by the member states. These pressures were intensified by the desire of a powerful group of six net contributors to cut the size of the EU budget, the 2004 and 2007 enlargements notwithstanding. Finally, the pressure on the UK was intensified because the presence on the agenda of the UK rebate pitted this country against all other 24.

All of these factors were seen to help shape the final agreement, showing 'why' as well as 'how' the final agreement differed in the ways it did from the original

[15] Hope for CAP reform is not lost, however. France and others had argued that the mid-term review of the 1999 CAP reform should not lead to further changes only for the 2003 reform to be, arguably, the most fundamental the CAP has seen.

proposal. The paper has also emphasised, however, the relatively tiny sums being debated. In the final hours one 'gesture', later praised for representing a spirit of cohesion and for helping remove the Polish threat to veto the final UK proposal, was the granting to Poland by German Chancellor Angela Merkel of €100 million for cohesion spending, that had been earmarked for eastern Germany: a 'gesture' that represented less than one-fifth of one per cent of expected cohesion payments to Poland over 2007-2013.

In September 2005 Nikolaos Vakalis, a Greek MEP, asked the Council how the planned reduction in spending would affect enlargement. The reply[16] stated that it is "clear that the fifteen "old" Member States are ready to play their part in carrying forward the enlargement agenda", to which should be added, given the analysis of this paper: so long as it does not affect their receipts from the EU budget. As a final observation, even with the December 2005 agreement, the debate has not yet finished. The deal must be approved by the European Parliament, which supported the Commission proposals. It will be the job of the Austrian Presidency to balance the demands of MEPs to raise spending where it has been cut, with the expectations of the member states that their hard-won agreement will not be changed.

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Appendix: Details of the Council Presidency Negotiating Boxes, 2005

Date	Document number	Additional Comments
2 June	9637/05 CADREFIN 115	This first Luxembourg document includes only some planned spending figures
15 June	10090/05 CADREFIN 130	This includes spending by line but not details of total Commitment and Payment Appropriations
17 June	10090/05 ADD 1 CADREFIN 130	This further amends some text and two spending lines (1b and 5). It also includes the full Financial Perspective, including Commitment and Payment Appropriations
5 December	UK EU Presidency Press Release	This is the first UK document
14 December	15649/05 CADREFIN 264	This revises the 5 December document
16 December	"PROVISIONAL VERSION"	This omits total spending on line 2 and thus has no full Financial Perspective
19 December	15915/05 CADREFIN 268	The final agreement

Note: A Negotiating Box from 19 May 2005 (document 9065/05, CADREFIN 108) is excluded because, whilst introducing several ideas incorporated into the 2 June document, it contains no detailed numbers for the Financial Perspective and virtually no detailed numbers in the accompanying text.

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