View metadata, citation and similar papers at core.ac.uk
brought to you by CORE
provided by Research Papers in Economics

UDC: 336.14;339.923
JEL Classification: E6, H77
Keywords: budget, European Union, growth

The EU Budget Dispute – A Blessing in Disguise?

Ondřej SCHNEIDER – Institute of Economic Studies, Faculty of Social Sciences, Charles University, Prague and CESifo Network Research Fellow (schneider@fsv.cuni.cz)*

Abstract
This paper analyses the current budget of the European Union and the relative position of the new member states. I argue that the EU budget should be reconsidered, as the union has expanded to 27 member states and has become more heterogeneous. The budget priorities should be re-oriented toward growth enhancing spending programs. A simple economic growth model illustrates that the EU budget is, at best, neutral with respect to EU-wide long-term growth potential, and may actually hamper growth in the majority of member states if the distortionary nature of taxation is taken into account.

1. Introduction

The European Union went through a difficult time in 2005. First, voters in France and the Netherlands rejected the Constitutional Treaty and the EU summit failed to approve the new budget outlook for 2007-2013 proposed by the European Commission. After frantic negotiations and concessions from Germany, Britain and the new member states, the outlook was approved in December 2005 and a review of the budget was promised in 2008–2009.

The European Union budget is tiny – about 1 % of the Union's GNI – compared to national public budgets, which typically consume more than 40 % of a given country's GNI. Still, even this small budget is a legitimate concern for policy makers and analysts, as it represents about € 120–150 billion annually, and for poorer countries transfers from the budget may reach as much as 4 % of their GDP, which is a significant amount, especially given such countries' frail budgetary position.[1]

The budgetary discussion has been difficult, which is not that surprising given the long list of contentious issues. The EU budget is subject to inter-governmental negotiations, and often bargains, so it is more a reflection of political preferences and historical compromises than a welfare-maximizing instrument. The enlargement of the EU has made this budgetary round more fragile. The European Union has to accommodate ten new member countries that joined the EU in 2004 and two more entrants – Bulgaria and Romania – that joined in 2007. As all these countries tend to be poorer than the existing members (with few exceptions) and tend to have larger agricultural sectors, the new EU make-up thus has serious budgetary consequences. At the same time, the EU is grappling with its ambitious "Lisbon agenda", which was

* This work was supported by Czech National Bank Research Project No. B5/2003.
I am grateful to CESifo, Munich, for its hospitality and stimulating environment, which helped to improve this paper. I would like to thank George Kopits, Thomas Harjes, Vladimir Bezděk, Kamil Dybczak, Tomáš Holub and Petr Zahradník for valuable comments.

[1] See (Schneider, Zapal, 2006).

launched in 2000 with the goal of creating "the most competitive economy" by 2010. These two developments put the two largest EU budgetary programs in the spotlight: the Common Agricultural Policy (CAP) and the Structural Funds (SF), which together consume 80 % of the EU budget.

In this paper, we aim to provide a comprehensive discussion of the EU budget's outlook and an analysis of its efficiency in achieving the goals set by national and Union authorities. The paper is organized as follows. After this introduction, we briefly discuss the EU budget for the period 2000–2006. In the Section 3, we analyze the budgetary data from 2004 – the first year in which the new member states contributed to the budget and drew resources from it. We show that the new members were unable to qualify for all the allocated funds, especially in agriculture and the structural funds.

Section 4 is devoted to the EU's budgetary proposal for the 2007–2013 financial framework. We analyze to what extent the proposed reshuffling of the EU budgetary priorities reflects economic reasons and to what extent it may be supportive of the Lisbon agenda's goals. We illustrate how the perspective was changed in late 2005 to accommodate member states' concerns and we show that the subsequent cuts were disproportionately concentrated in structural operations while agricultural subsidies were left largely intact.

Section 5 employs a simple growth model to determine the likely effects of the EU budget on the economic growth and performance of the EU member states. We find that, once the distortionary nature of taxation is taken into account, the EU budget increases growth in ten EU-25 member countries and has an insignificant or mildly negative impact on the remaining fifteen. If we take the EU-25 as a single entity, the EU budget most probably has a negligible effect. The new member states are, however, more likely to get a positive stimulus from investment in physical and human capital.

Section 6 is devoted to a brief analysis of the new financial framework's impact on new member states' budgets and we find that the new framework for 2007–2013 maintains their inferior position vis-à-vis the old member countries. We also suggest a re-shaping of the EU budget to reflect the new set-up of the Union, which now consists of 27 widely income-different countries. In accordance with other analyses, we argue that the enlarged Union cannot continue to support the excessively expensive agricultural policy, which brings no tangible economic benefits. Also, slashing agricultural spending would allow the EU budget to concentrate on programmes with Union-wide effects. The last section concludes the paper and offers some tentative recommendations.

2. EU Budget and Enlargement

The European budget has been a contentious issue for the member states since its conception in 1952 (as a small budget of the European Coal and Steel Community, as it was then known). Regardless of the EU's cherished community spirit, most countries have treated the budget as a battle for funds among countries. Thus, the budget reflects more historical than economic forces and, from this perspective, could be considered a "historical relic".[2] In this section, we will discuss the impact of the 2004 enlargement on the EU budget.

Eight Central and Eastern European countries and two Mediterranean islands became new member states (NMSs) of the European Union in May 2004.[3] In budgetary terms, their membership was accommodated by the Copenhagen European Council in 2002. The NMSs were given total commitments of € 41 billion and they are expected to contribute € 15 billion to the budget.

Prior to their entry into the EU, there were many estimates as to the budgetary impact of the NMSs' membership. Some studies, most notably (Kopits, Szekely, 2002), took a very pessimistic view, estimating that EU membership would worsen the budgetary balance in the NMSs by as much as 4.75 % of GDP for the Czech Republic, 4 % for Estonia and Hungary, and 3 % for Poland and Slovenia. As noted in (Hallet, 2004), their estimates were based on the assumption that all co-financing of the EU structural funds' spending would be new spending by national governments.

Hallet (2004) reached less negative results for the Polish budget. He estimated that the fiscal balance may worsen by approximately 1 % of GDP as a result of EU membership, arguing that a substantial part of the EU payments would not benefit the government budget but would go straight to the final recipients, often private (farmers) or independent from the government (universities).

Other estimates were more cautious. Backé (2002) estimated the net effect of EU membership on the net fiscal balance "over the medium term" as neutral. Besides being less aggressive on co-financing, he also assumed lower administration costs and quantified the "positive growth effect" of EU membership, which should improve the budgets of the NMSs by 0.5–1.0 % of GDP.

Even more optimistic are Hallet and Keereman (2005) who argued that the NMSs would gain from membership, partly due to the negotiated "compensation scheme", which directs € 1–1.4 billion to the NMSs in the 2004–2006 period. They estimated that the NMSs would gain, on average, 0.9 % of GDP in 2004, 1.5 % of GDP in 2005 and 1.6 % of GDP in 2006. The biggest net receiver was Lithuania, which may have received 2–2.5 % of GDP in net transfers in 2006.[4] Latvia was scheduled to receive a net 2 % of GDP in 2006. The lowest net gains were expected in Cyprus, Slovenia, Hungary and the Czech Republic (around 0.5 % of their GDPs). These estimates are supported by our analysis of the 2004 data (see Section 3).

The crucial point in Hallet's analysis is the interpretation of the co-financing requirements and the so-called "additionality" of the EU budget payments. Using European Commission documents, Hallet argues that additionality requires only limited additional spending from the NMSs' budgets, ranging from 0.1 % of GDP for Cyprus to 1 % of GDP for Latvia in 2006. The average co-financing requirement was only 0.5 % of GDP in both 2005 and 2006. These low requirements (compared to Kopits and Szekely) were based on the European Commission interpretation that the additional requirement relates only to EU funding, not to national co-funding. Thus, the NMSs are free to reallocate their spending towards projects not financed by the EU structural funds and this reallocation may be at the expense of potentially EU-financed programs. Given, however, that most NMSs already spend more than 3 % of their

[2] This term was first used by the Sapir report, 2003.

[3] Bulgaria and Romania joined the EU in 2007, but the budgetary data available for the two countries do not allow them to be included in our analysis.

[4] A part of this reflects the EU's specific allowance for decommissioning the Ignalia nuclear plant.

GDP on capital formation that is eligible for structural fund and Cohesion Fund financing, it should be fairly easy for the NMSs to satisfy the additionality requirement.

It should be stressed that these estimates typically do not quantify the benefits that the NMSs and their budgets may gain from EU membership. It is fair to expect that membership will have a positive sustained impact on growth and employment in the longer run (see Section 4). This, in turn, will be reflected in an endogenous windfall gain in income tax revenue and a decline in social transfers.

3. The New Member States and the Budget in 2004

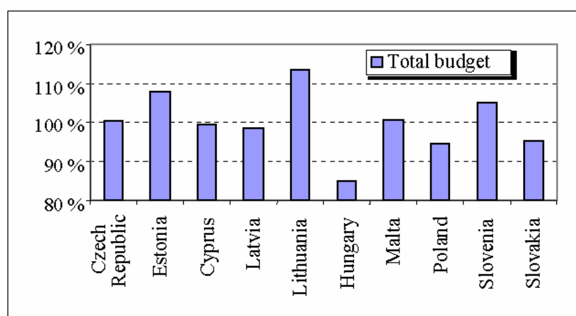
The first year the new member states spent in the EU – i.e. part of 2004, as they joined the EU on 1 May – presents an opportunity to analyse the real impact of the EU budget on these countries. For this purpose, we compare "appropriations for payments" as approved at the EU's Copenhagen summit in 2002 with the actual 2004 data as reported in European Commission (2005). The available data show the sums that were appropriated in the EU budget for the new member states. The actual spending will not be known until the end of 2007, when the transfers must be cleared and approved by the European Commission. Therefore, the data in the *Table 1* do not show the final spending, but the maximum amounts that these countries can qualify for. Even then, most countries diverged from what the EU budget had envisaged.

As *Table 1* illustrates, the total expected budget for 2004 was not fulfilled, as the new member states qualified for less than € 6 billion, while the appropriations were € 6.2 billion. The biggest "underachiever" was Hungary, which qualified for only € 700 m instead of the expected € 825 m (85 %). In absolute terms, Poland lost some € 154 m. On the other hand, Lithuania could, if all programs receive approval, spend almost € 480 m, some € 57 m or 13 % more than it was supposed to. The Czech Republic, Cyprus, Latvia and Malta all came very close to the originally planned sums. *Figure 1* illustrates the individual countries' standings vis-à-vis the Copenhagen plan.

Looking at the structure of the transfers, the new member states received two basic categories of budgetary transfers from the EU budget in 2004. Roughly one-half of the total transfers – € 2.7 billion, i.e. 48 % of the total – financed structural operations, agricultural transfers and internal policies (such as research and development, consumer protection, etc.). Although the economic ratios for these policies vary widely, they are all constant fixtures in the EU budget. The remaining € 3.2 billion was transferred to the new members through two specific instruments – Pre-Accession Aid and Compensation for New Member States. These programs either have been phased out already, or will diminish quickly (compensation fell from € 1.2 billion in 2004 to € 900 m in 2006).

Therefore, one may argue that the former group of budgetary transfers is more important, as it better reflects the countries' ability to draw money through regular processes and this ability will be crucial if a given country is to improve its budgetary position vis-à-vis the EU budget. The two parts of *Figure 2* thus show the "success rate" of the new member countries in the two expenditure categories. It is interesting that only Lithuania was able to fill its "quota" of the "structural funds". Other countries typically qualified for 95 % of the allocated sum; only Slovenia and Cyprus managed just 90 % of the allocated resources. As far as compensation is concerned, only

FIGURE 1 Budget Transfers from EU Budget as a Percentage of the Copenhagen Plan



Source: Author

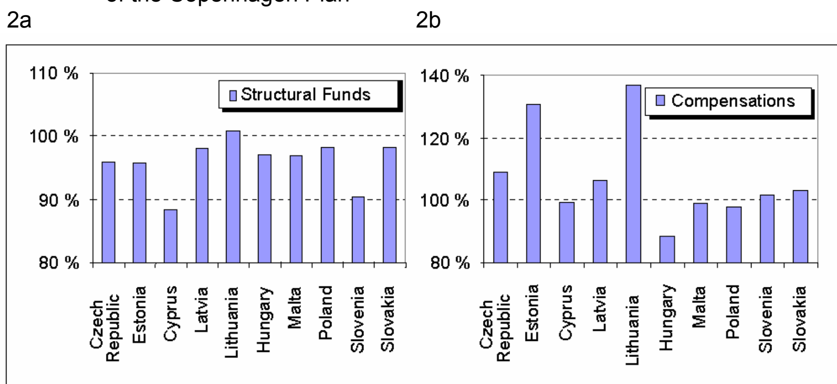
TABLE 1 EU Budget 2004 Spending in the New Member States: Plan versus Reality (EUR millions)

Area	Agriculture	Structural Operations	Internal Policies	Pre-Accession and Compensation	TOTAL
Cyprus:					
Perspective	12.4	6.0	5.7	107.6	131.7
Budget	7.5	5.3	11.1	107.0	130.9
Czech Republic:					
Perspective	100.0	168.5	51.0	481.0	800.5
Budget	90.8	161.7	26.9	514.2	793.6
Estonia:					
Perspective	28.8	39.2	30.7	82.8	181.5
Budget	15.6	37.5	34.5	108.1	195.7
Lithuania:					
Perspective	72.8	93.6	94.5	161.8	422.7
Budget	49.5	94.4	114.0	221.5	479.4
Latvia:					
Perspective	42.1	66.2	37.2	118.5	264.0
Budget	32.8	64.9	37.1	125.8	260.6
Hungary:					
Perspective	124.7	209.2	100.3	390.3	824.5
Budget	60.7	203.1	92.2	344.7	700.7
Malta:					
Perspective	3.4	6.6	2.4	57.0	69.4
Budget	2.7	6.4	4.3	56.4	69.8
Poland:					
Perspective	425.7	859.0	154.0	1 412.8	2 851.5
Budget	297.4	843.5	176.6	1 379.6	2 697.1
Slovakia:					
Perspective	57.2	118.2	39.8	183.2	398.4
Budget	41.1	116.1	34.2	188.3	379.7
Slovenia:					
Perspective	43.4	27.0	49.7	145.9	266.0
Budget	49.4	24.4	57.9	148.2	279.9
Total EU-10					
Perspective	**910.5**	**1 593.5**	**565.3**	**3 140.9**	**6 210.2**
Budget	**647.5**	**1 557.3**	**588.8**	**3 202.9**	**5 996.5**

Source: (European Commission, 2005) and author's calculations

FIGURE 2a "Structural" Transfers from the EU Budget as a Percentage of the Copenhagen Plan

FIGURE 2b "Compensation" Transfers from the EU Budget as a Percentage of the Copenhagen Plan



Source: author

Poland and Hungary did not qualify for the whole amount. Lithuania, on the other hand, may receive € 60 m more than was planned – a hefty bonus of 37 %.

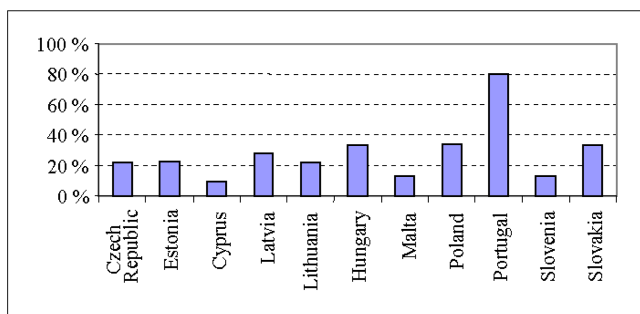
Finally, we look at the spending items for which the EU budget money was used. As we show later, not all expenditures support economic growth. Moreover, as Dall'erba and Le Gallo (2007) argue, the EU funds even fail to support convergence of European regions significantly. Some expenditures may, in fact, undermine long-term growth by, for example, encouraging interest groups to capture part of government spending. Therefore, we divide expenditures into two categories: productive and unproductive. While the division is arbitrary, we believe it captures the most important features of spending. Kneller, Bleany and Gemmel (1999) made a similar distinction in their paper, where they classified expenditures with "substantial capital content" as productive.[5] Ederveen et al. (2002) argue that EU budget transfers may play a different role than promoting economic efficiency (enhancing cultural or environmental values, for example), but this view has an obvious deficiency in its vagueness.

Therefore, we classify the following spending programmes as "productive": all structural operations, i.e. including the Cohesion Fund. Furthermore, from among the Internal Policies, we classify spending on training and research and development as "productive". Among the 25 EU members, Portugal seems to be the record holder, as it spends 80 % of EU budget transfers on "productive" programs. Among the "old" EU-15, Luxembourg uses only 5% of total transfers in productive ways. However, Luxembourg is very special, as a full 90 % of its transfers come in administrative expenses. Among the more typical members, Austria and Belgium receive only about 20 % of transfers in the productive category (see *Table 2*).

The share of productive investment differs widely among the new member states (see *Figure 3*). The highest share – one-third – is recorded for Poland, Slovakia

[5] The authors classified spending on public services, defense, education, health, housing and transport as productive. The paper, though, concentrated on national budgets within the OECD countries.

FIGURE 3 Share of Productive Transfers from the EU Budget in New Member States (and Portugal)



Source: author

and Hungary. On the other hand, Cyprus, Malta and Slovenia spend only about 10 % of total EU budget transfers on "productive" investments. On average, the new member states tend to spend less on productive investments – only 23 % of total EU budget transfers – than the "old" members.

We may thus conclude that the new member states failed to use the EU budget appropriations fully, but the result is not homogeneous for all countries. Estonia and

TABLE 2 Spending from the EU Budget, selected categories (% of GNI)

	Agriculture	**Structural Funds**	**Internal Policies**	**TOTAL**	**Total Productive**
Belgium	0.38 %	0.12 %	0.26 %	**1.72 %**	0.31 %
Czech Republic	0.11 %	0.20 %	0.04 %	**1.01 %**	0.22 %
Denmark	0.62 %	0.10 %	0.07 %	**0.81 %**	0.15 %
Germany	0.29 %	0.21 %	0.04 %	**0.55 %**	0.25 %
Estonia	0.20 %	0.46 %	0.43 %	**2.51 %**	0.56 %
Greece	1.70 %	1.72 %	0.11 %	**3.54 %**	1.81 %
Spain	0.81 %	1.22 %	0.03 %	**2.07 %**	1.25 %
France	0.57 %	0.15 %	0.05 %	**0.79 %**	0.19 %
Ireland	1.51 %	0.68 %	0.07 %	**2.29 %**	0.73 %
Italy	0.38 %	0.34 %	0.06 %	**0.79 %**	0.38 %
Cyprus	0.06 %	0.04 %	0.10 %	**1.22 %**	0.12 %
Latvia	0.30 %	0.60 %	0.34 %	**2.46 %**	0.68 %
Lithuania	0.28 %	0.54 %	0.66 %	**2.79 %**	0.60 %
Luxembourg	0.17 %	0.13 %	0.31 %	**4.79 %**	0.26 %
Hungary	0.08 %	0.27 %	0.12 %	**0.95 %**	0.31 %
Malta	0.06 %	0.15 %	0.09 %	**1.77 %**	0.23 %
Netherlands	0.29 %	0.08 %	0.09 %	**0.47 %**	0.15 %
Austria	0.49 %	0.14 %	0.06 %	**0.70 %**	0.18 %
Poland	0.16 %	0.44 %	0.09 %	**1.42 %**	0.48 %
Portugal	0.63 %	2.63 %	0.07 %	**3.34 %**	2.68 %
Slovenia	0.19 %	0.09 %	0.22 %	**1.08 %**	0.14 %
Slovakia	0.12 %	0.35 %	0.09 %	**1.15 %**	0.38 %
Finland	0.59 %	0.24 %	0.06 %	**0.91 %**	0.30 %
Sweden	0.31 %	0.15 %	0.05 %	**0.52 %**	0.20 %
UK	0.24 %	0.13 %	0.03 %	**0.41 %**	0.16 %
EU	0.42 %	0.34 %	0.05 %	**0.89 %**	**0.38 %**

Source: Allocation of EU Expenditure by Member State, (European Commission, 2005)

Lithuania received the most, mainly due to their success in attracting "compensation" payments from the EU budget. On the other hand, Hungary and Poland fared the worst, mostly due to their mediocre record in receiving "compensation payments". The new member states underperformed in comparison with the old members also in the productive investment ratio, as most of the transfers were geared either towards agricultural subsidies or towards unspecified "compensation" schemes.

4. The New Financial Perspective for 2007-2013

The negotiations of the new financial perspective were complicated by the recent enlargement, which has increased the number of countries and also the number of compromises and potential horse-trading required to reach a deal. The main contentious issues have been the size of the budget (1 % or 1.24 % of EU GDP), the restructuring of the budget so as to give more support to the EU's main economic policy package – the Lisbon agenda, the treatment of the new member states, and the future of the United Kingdom's rebate. In December 2005, an amended financial perspective was approved by the European Council, which fixed total spending (commitments) in 2007–2013 at € 862 billion (1.045 % of EU GDP). The deal cuts € 160 billion from the original Commission proposal, with the cuts (ironically) concentrated in the first heading of the budget, i.e. the "sustainable growth" chapter (where a massive € 90 billion was shaved from the EC's budget proposal). We will discuss these issues in this section.

4.1 The Size of the Budget

As we noted in the previous section, the EU budget accounts for a small share of public expenditures across the EU. While average public expenditures in the EU were 48 % of GDP in 2003,[6] the EU's central budget hovers around 1 % of total EU GDP.[7] Indeed, it fell from 1.05 % of GDP in 1992 to 0.98 % in 2003. Nevertheless, the budget is criticized as "a historical relic […] inconsistent with the present and future state of EU integration" (see the Sapir report, p. 162). The report goes on to argue that the EU budget is a means of redistributing funds from one group of citizens to another. As such, it often degenerates to a zero-sum game in which individual countries compete to divert as much of the budget as possible to their own benefit, disregarding the EU-wide benefits. This is confirmed by our growth analysis in Section 5 below, which shows the negligible impact of the EU budget on EU-wide economic growth.

4.2 The Structure of the Framework 2007–2013

The financial framework proposal submitted by the European Commission to the June 2005 Luxembourg summit was rejected at the summit. The falling-out was apparently driven by a long-standing British-French conflict over the two most contentious EU budget items: the CAP and the UK's rebate. Nevertheless, these feuds were present during the previous budget negotiations and eventually gave way to a compromise. Indeed, the December 2005 summit reached a compromise whereby the EU budget was set at 1.045 % of the EU's GNI level. The financial perspective

[6] See (European Commission, 2004b).

[7] Indeed, the Sapir report argues that the national budgets, which account for 97.5 % of public spending within the EU, need reform as urgently as the EU budget.

TABLE 3 Financial Framework for 2007-2013, versions from June and December 2005 (2005 prices, EUR million)

	Version	2007	2008	2009	2010	2011	2012	2013	Total/ Average
1. Sustainable Growth	VI-2005	58,735	61,875	64,895	67,350	67,795	72,865	75,950	471,465
	XII-2005	51,090	52,148	53,330	54,001	54,945	56,384	57,841	379,739
	VI-2006	51,267	52,415	53,616	54,294	55,368	56,876	58,303	382,139
1a Comp. for Growth and Employ.	VI-2005	12,105	14,390	16,680	18,965	21,250	23,540	25,825	132,755
	XII-2005	8,250	8,860	9,510	10,200	10,950	11,750	12,600	72,120
	VI-2006	8,404	9,097	9,754	10,434	11,295	12,153	12,961	74,098
1b Cohesion for Growth and Employ.	VI-2005	46,630	47,485	48,215	48,385	48,545	49,325	50,125	338,710
	XII-2005	42,840	43,288	43,820	43,801	43,995	44,634	45,241	307,619
	VI-2006	42,863	43,318	43,862	43,860	44,073	44,723	45,342	308,041
2. Preserv. and Mngt of Natural Res.	VI-2005	57,180	57,900	58,115	57,980	57,850	57,825	57,805	404,655
	XII-2005	54,972	54,308	53,652	53,021	52,386	51,761	51,145	371,244
	VI-2006	54,985	54,322	53,666	53,035	52,400	51,775	51,161	371,344
Of which: Agriculture	VI-2005	43,500	43,673	43,354	43,034	42,714	42,506	42,293	301,074
	XII-2005	43,120	42,697	42,279	41,864	41,453	41,047	40,645	293,105
	VI-2006	43,120	42,697	42,279	41,864	41,453	41,047	40,645	293,105
3. Citizenship	VI- 2005	2,570	2,935	3,235	3,530	3,835	4,145	4,455	24,705
	XII-2005	1,120	1,210	1,310	1,430	1,570	1,720	1,910	10,270
	VI-2006	1,199	1,258	1,380	1,503	1,645	1,797	1,988	10,770
4. Global player	VI-2005	11,280	12,115	12,885	13,720	14,495	15,115	15,740	95,350
	XII-2005	6,280	6,550	6,830	7,120	7,420	7,740	8,070	50,010
	VI-2006	6,199	6,469	6,739	7,009	7,339	7,679	8,029	49,463
5. Administration	VI-2005	3,675	3,815	3,950	4,090	4,225	4,365	4,500	28,620
	XII-2005	6,720	6,900	7,050	7,180	7,320	7,450	7,680	50,300
	VI-2006	6,633	6,818	6,973	7,111	7,255	7,400	7,610	48,800
6. Compensation	VI-2005	0,120	0,060	0,060	0	0	0	0	0,240
	XII-2005	0,419	0,191	0,190	0	0	0	0	0,800
	VI-2006	0,419	0,191	0,190	0	0	0	0	0,800
TOTAL Commitments	VI-2005	133,56	138,70	143,14	146,67	150,20	154,32	158,45	1,025,04
	XII-2005	120,60	121,31	122,36	122,75	123,64	125,06	126,65	862,36
	VI-2006	120,70	121,47	122,56	122,95	124,01	125,53	127,09	864,32
TOTAL in % of GNI	VI-2005	1,15 %	1,23 %	1,12 %	1,08 %	1,11 %	1,14 %	1,15 %	1,15 %
	XII-2005	1,10 %	1,08 %	1,06 %	1,04 %	1,03 %	1,02 %	1,00 %	1,05 %
	VI-2006	1,10 %	1,08 %	1,07 %	1,04 %	1,03 %	1,02 %	1,01 %	1,05 %
TOTAL Payments	VI-2005	124,60	136,50	127,70	126,00	132,40	138,40	143,10	928,70
	XII-2005	116,65	119,54	111,83	118,00	115,60	119,07	118,62	819,38
	VI-2006	116,65	119,62	111,99	118,28	115,86	119,41	118,97	820,78
TOTAL in % of GNI	VI-2005	1.07 %	1.21 %	1.00 %	0.93 %	0.98 %	1.02 %	1.04 %	1.04 %
	XII-2005	1.06 %	1.06 %	0.97 %	1.00 %	0.96 %	0.97 %	0.94 %	0.99 %
	VI-2006	1.06 %	1.06 %	0.97 %	1.00 %	0.96 %	0.97 %	0.94 %	1.00 %

Sources: Towards a New Financial Perspective 2007–2013, European Commission, June 2005,

Council of the European Union, document 15915/05, December 2005,

Interinstitutional Agreement between the EP, the Council and the Commission on budgetary discipline and sound fiscal management 2006/C139/01, 23 June 2006

(available at: http://ec.europa.eu/budget/prior_future/next_fin_framework_en.htm).

was then little changed in a deal made between the European Parliament, Commission and Council in June 2006. The winners of the negotiations were France and the CAP. While the "competitiveness" budget was cut by a massive € 59 billion (over the 2007–2013 period) and the cohesion funds by a further € 30 billion, agricultural spending barely budged, falling by € 8 billion (see *Table 3*).

The rejigged budget abolished the current structural funds and merged them into the sustainable development objective. The current CAP has been moved to "natural resources management". The Commission's original proposal envisaged agricultural spending falling from 42 % of the EU budget in 2004 to 26 % in 2013. However, the amended budget proposal envisages the share of agriculture as being 34 % in 2013. Moreover, further funds will be allocated to agriculture through the rural development facility.

4.3 Competitiveness for Growth and Employment

This first objective is inspired by the Sapir report and is aimed at promoting economic growth. The Commission argues that the main objectives within this objective (sic) are: a) promoting competitiveness in fully integrated internal markets, b) strengthening European research and technological development, c) connecting the EU through networks, d) improving the quality of education and training, and e) helping European society to manage change with social policy. While these are rather vague principles, two aspects stand out. First, the Commission advocates full integration of EU markets, i.e. including the hitherto fragmented service sector. Second, the Commission supports the Lisbon agenda's goal of 3 % of GDP expenditure on research and development by boosting its expenditure on this agenda. However, the December 2005 negotiations cut an awesome € 90 billion from this objective, the greatest cut among all the objectives in absolute terms.

4.4 Cohesion for Growth and Employment

The Commission included three main areas within this objective: a) convergence with a focus on the less developed member states and regions, including "statistical effect regions", b) regional competitiveness and employment, and c) European territorial cooperation.

The Commission proposal brings one fundamental change from the previous financial framework: the cohesion policy changes from being a time-limited and geographically focused policy to a permanent policy pursuing "balanced territorial development". This was strongly opposed by the new member states, but also by the UK and Sweden, which argued that cohesion funds should be allocated exclusively to the poorest member states and should not be allocated on a regional level (NUTS II). Furthermore, in the second objective – regional competitiveness – all regions within the EU become eligible, including the richest ones. Indeed, the Commission estimates that about 50 % of the total funding will go to the EU-15 in the 2007–2013 period, the remaining half being directed at the ten new members from 2004 and Bulgaria and Romania.

4.5 Preservation and Management of Natural Resources

This is the second largest spending program in the new financial perspective, accounting for almost 40 % of the total budget, i.e. € 404 billion. Four-fifths of this

objective is earmarked for CAP expenditures, 20 % goes to rural development programs and the remaining funds are allocated for fishery and, finally, environmental purposes.[8] The biggest item, CAP payments, is expected to grow by 1 % annually in nominal terms, thus precipitating a slow decline in these payments in real terms and also as a share of the EU budget.

5. The EU Budget and Potential Economic Growth

In this section we will discuss the impact of the EU budget on the potential growth performance of the European Union member countries. For that purpose, we will modify a simple overlapping generations growth model, applied by Tanzi and Chalk in (Buti et al., 2002) and inspired by Barro (1991) and Mendoza (1997). We will then apply the model results to the EU budget data to assess the budget's contribution to economic growth in individual countries and in the whole EU. We should stress that this exercise ignores the short-term demand effects of EU budget transfers, no matter how strong they might be. While we follow a rather standard classification (see, for example, (Kneller, Bleany, Gemmel, 1999)), our analysis makes an unavoidably normative decision as to which expenditures (may) contribute to economic growth. Finally, we concentrate on long-term effects, as these will shape each country's performance for years to come. Also, our analysis treats the EU budget as independent from the national budgets. Therefore, we assume that contributions paid by states require higher taxes to be paid within these states. By the same token we treat transfers from the EU budget as "new" spending complementary to the national budgets' outlays. One may argue, however, that national and EU expenditures are rather substitutes. If that was the case, the EU budget would be insignificant by definition and could be abolished with no effect on economic variables.

While the Tanzi and Chalk model is very simple, its conclusions were supported by a more sophisticated analysis by Ederveen, de Groot and Nahuis (2002), who empirically explored the effectiveness of the European budget using a panel data analysis for 13 countries in the European Union. They show that the structural funds are weakly effective for countries with the proper institutional framework. The latter result is obtained for a wide range of conditioning variables, such as openness, institutional quality, corruption and indicators for good governance. Where institutions are underdeveloped, the structural funds either do not influence economic growth or may even hamper it (see (Ederveen et al., 2002), for a discussion). Our model complements previous models by adding the (negative) impact of taxes used for raising necessary funds.

5.1 The Model

The model uses a classic production function with capital and labor, where capital comes in two forms: private K_t and public $K_{G,t}$. The production function has constant returns to scale with respect to the stock of public and private capital, but increasing returns to scale overall.

$$Y_t = K_{G,t}^{1-\alpha}\ K_t^{\alpha}\ L_t^{\beta} \quad \text{where } \alpha + \beta = 1 \tag{1}$$

[8] Most environmental programs are to be financed from the cohesion policy or external relations objective.

Households maximize their lifetime utility and every worker supplies one unit of labor every period. In order to make the model as simple as possible, we assume that the labor supply does not depend on taxes and that the saving rate is not influenced by the interest rate.

Consumption in the future depends on savings Z_t and the rate of return R_t. Optimal savings Z_t finance both private and public investment in the next period.

$$z_t = \frac{\xi}{\xi + 1} w_t (1 - t) = s w_t (1 - t) \tag{2}$$

The government finances its budget by levying a uniform tax rate t on all income from capital and labor. It then spends the entire budget on new capital G_t and on servicing debt B_t:

$$\begin{aligned} B_{t+1} &= R_t B_t + G_t - t(w_t L_t + R_t K_t + R_t B_t) \\ K_{G,t+1} &= (1 - \delta_G) K_{G,t} + G_t - K_{G,t} \end{aligned} \tag{3, 4}$$

where δ_G is the depreciation rate for public capital (we assume a zero depreciation rate for private capital K_t).

Firms maximize profit:

$$\max_{K_t, L_t} K_{G,t}^{1-\alpha} K_t^{\alpha} L_t^{\beta} - w_t L_t - r_t K_t \tag{5}$$

Capital and labor are paid according to their marginal productivity:

$$R_t = 1 + \alpha \frac{Y_t}{K_t}; \quad w_t = \beta \frac{Y_t}{L_t} \tag{6}$$

As we assume perfect capital markets, in every period savings equal investment:

$$z_t L_t = s(1-t)\beta Y_t = B_{t+1} + K_{t+1} \tag{7}$$

And private capital grows with total savings and falls with increasing government debt B_t and increasing taxes. So we may formulate a "crowding-out equation" (8):

$$K_{t+1} = s(1-t)\beta Y_t - B_{t+1} \tag{8}$$

Finally, we derive the growth equation. Growth could be disaggregated into the three factors' contributions:

$$\frac{Y_{t+1}}{Y_t} = \left(\frac{K_{G,t+1}}{Y_t} \right)^{1-\alpha} \left(\frac{K_{t+1}}{Y_t} \right)^{\alpha} L_{t+1}^{\beta}; \quad \text{where } L_t = 1 \tag{9}$$

Substituting for private and public capital from equations (4) and (8) allows us to express the growth as a function of public capital $K_{G,t}$, the tax rate t and the relative debt level B_t:

$$\frac{Y_{t+1}}{Y_t} = \left(\frac{G - \delta_G K_{G,t}}{Y_t} \right)^{1-\alpha} \left(s(1-t)\beta - \frac{B_{t+1}}{Y_t} \right)^{\alpha} L_{t+1}^{\beta} \tag{10}$$

Equation (10) allows us to disentangle the effects of government fiscal policy on economic growth. While increasing public capital $K_{G,t}$ increases economic growth, its financing growth decreases, either through the tax effect or through the debt effect. The debt effect is straightforward: the higher the debt B, the lower the growth. The tax effect has two channels: first, taxes lower growth. But at the same time, the higher taxes allow a decrease in debt, i.e. they may encourage growth. However, the former tax effect is of a stronger magnitude and dominates the effect of (possibly) lower debt. The total effect of government policy depends on parameters α and β.

5.2 The Growth Effect

The Tanzi and Chalk model can be estimated and these estimates may be used in calculations of the total potential growth effect. Tanzi and Chalk estimated that debt lowers growth by a factor of 0.02, direct taxes lower growth by a factor of 0.08 and public investment boosts growth by a factor of 0.25. Nevertheless, these elasticities at least provide us with some crude estimates of the EU budget's effect on the EU-wide economy. Kneller, Bleany and Gemmel (1999) estimated that "distortionary taxes"[9] cut growth by a factor of 0.44, while non-distortionary taxes[10] made no impact. According to Kneller et al., productive investment increases growth by a factor of 0.27, i.e. very similarly as in the Tanzi-Chalk specification.

To assess the growth impact of the EU budget we used the European Commission analysis of allocation of expenditures and revenues by member state (European Commission, 2005). This allows us to distribute among all 25 EU member states. *Table 4* summarizes the payments of individual countries to the EU budget.

The most important is the TOTAL column, which shows the total contributions of individual countries from various distorting tax sources. *Table 4* illustrates that the highest share of national income (and thus the highest distortion) is borne by Belgium, which pays 1.34 % of its GNI to the budget. The lowest burden falls on the UK, due to its rebate. The ten new member states of the EU had been members for only eight months, so their contributions are proportionally lower. Three out of the four countries that are almost completely excluded from financing the UK's rebate – Germany, Austria and Sweden – also fare relatively well.[11]

Table 5 shows the allocation of expenditures by member state for various expenditure categories. In order to assess their impact on economic growth, we have to disentangle these categories into those that can be attributed to capital accumulation – productive investment – and those that serve other purposes, mostly redistributive. As argued above, we classified structural operations, spending on training and spending on research and development as "productive". While education and training clearly do not contribute to physical capital, it can be argued that they increase human capital and thus increase economic growth.[12]

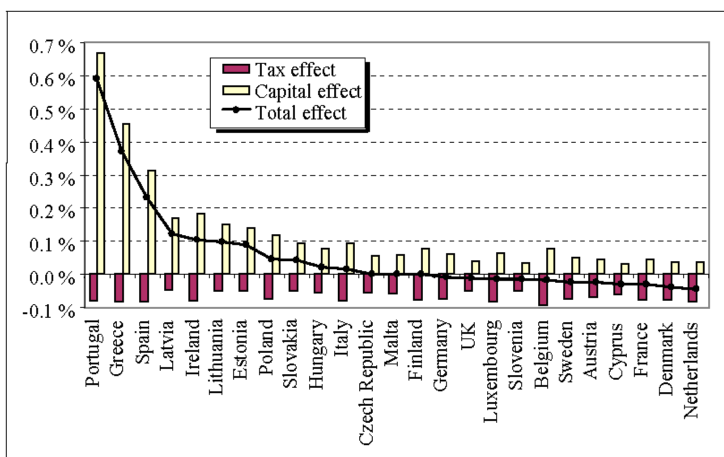
[9] Defined in their paper as taxes on income and profit, social security contributions, payroll and labor taxes and taxes on property.

[10] All taxes on domestic goods and services.

[11] The fourth – the Netherlands – has its contributions boosted by the high customs duties that are collected in its ports, even though the costs are borne by customers, mostly in Germany.

[12] See also Section 3 for a detailed discussion.

FIGURE 4 Growth Effect of the EU Budget 2004 (% of GNI)



Source: author's calculations

TABLE 4 Distribution of Resource Payments by Member States in 2004 (% of GNI)

	TRADITIONAL OWN RESOURCES	VAT BASED OWN RESOURCES	GNI BASED OWN RESOURCES	UK REBATE	TOTAL
Belgium	*0.44 %*	0.12 %	0.69 %	0.09 %	**1.34 %**
Czech Republic	*0.07 %*	0.10 %	0.46 %	0.06 %	**0.69 %**
Denmark	*0.13 %*	0.11 %	0.68 %	0.08 %	**1.00 %**
Germany	*0.11 %*	0.12 %	0.68 %	0.02 %	**0.93 %**
Estonia	*0.09 %*	0.09 %	0.44 %	0.06 %	**0.68 %**
Greece	*0.12 %*	0.15 %	0.70 %	0.09 %	**1.06 %**
Spain	*0.12 %*	0.15 %	0.70 %	0.09 %	**1.06 %**
France	*0.07 %*	0.14 %	0.68 %	0.09 %	**0.98 %**
Ireland	*0.10 %*	0.15 %	0.68 %	0.09 %	**1.02 %**
Italy	*0.09 %*	0.15 %	0.69 %	0.09 %	**1.02 %**
Cyprus	*0.16 %*	0.10 %	0.47 %	0.06 %	**0.79 %**
Latvia	*0.07 %*	0.08 %	0.41 %	0.06 %	**0.62 %**
Lithuania	*0.08 %*	0.09 %	0.45 %	0.06 %	**0.68 %**
Luxembourg	*0.06 %*	0.16 %	0.72 %	0.09 %	**1.03 %**
Hungary	*0.07 %*	0.10 %	0.47 %	0.06 %	**0.70 %**
Malta	*0.12 %*	0.10 %	0.47 %	0.06 %	**0.75 %**
Netherlands	*0.30 %*	0.14 %	0.69 %	0.01 %	**1.14 %**
Austria	*0.08 %*	0.11 %	0.70 %	0.01 %	**0.90 %**
Poland	*0.06 %*	0.10 %	0.68 %	0.09 %	**0.93 %**
Portugal	*0.09 %*	0.14 %	0.69 %	0.09 %	**1.01 %**
Slovenia	*0.05 %*	0.10 %	0.45 %	0.06 %	**0.66 %**
Slovakia	*0.06 %*	0.09 %	0.46 %	0.06 %	**0.67 %**
Finland	*0.06 %*	0.14 %	0.68 %	0.09 %	**0.97 %**
Sweden	*0.11 %*	0.13 %	0.70 %	0.01 %	**0.95 %**
UK	*0.13 %*	0.15 %	0.69 %	-0.30 %	**0.67 %**
EU	***0.12 %***	**0.14 %**	**0.68 %**	**0.00 %**	**0.94 %**

Source: European Commission (2005).

TABLE 5 Allocation of Expenditure by Sector and by Member State in 2004 (% of GNI)

	AGRICULTURE						STRUCTURAL OPERATIONS				INTERNAL POLICIES						
	Direct Aid	**Export Refunds**	**Storage**	**Rural Develop.**	**Other**	***Total Agric.***	**Struct. Funds**	**Other Struc-tural**	**Cohe-sion Funds**	***Total Struc-tural***	**Training, culture**	**Energy, environ.**	**Consu-mer pro-tection**	**R&D**	**Other**	***Total Internal***	**TOTAL**
Belgium	0,14	0,17	0,01	0,02	0,04	*0,38*	0,12	0,00	0,00	*0,12*	0,04	0,01	0,04	0,15	0,02	*0,26*	**1,72**
Czech	0,00	0,00	0,00	0,11	0,00	*0,11*	0,20	0,00	0,00	*0,20*	0,01	0,00	0,00	0,01	0,02	*0,04*	**1,01**
Denmark	0,44	0,13	0,00	0,02	0,03	*0,62*	0,10	0,00	0,00	*0,10*	0,01	0,02	0,00	0,04	0,00	*0,07*	**0,81**
Germany	0,21	0,02	0,01	0,04	0,01	*0,29*	0,21	0,00	0,00	*0,21*	0,01	0,00	0,00	0,03	0,00	*0,04*	**0,55**
Estonia	0,00	0,01	0,00	0,19	0,00	*0,20*	0,46	0,00	0,00	*0,46*	0,06	0,01	0,32	0,04	0,00	*0,43*	**2,51**
Greece	1,15	0,01	0,01	0,08	0,45	*1,70*	1,51	0,00	0,21	*1,72*	0,03	0,00	0,01	0,06	0,01	*0,11*	**3,54**
Spain	0,55	0,02	0,01	0,07	0,16	*0,81*	0,97	0,00	0,25	*1,22*	0,01	0,00	0,00	0,02	0,00	*0,03*	**2,07**
France	0,44	0,03	0,00	0,05	0,05	*0,57*	0,15	0,00	0,00	*0,15*	0,01	0,00	0,01	0,03	0,00	*0,05*	**0,79**
Ireland	0,90	0,18	0,03	0,29	0,11	*1,51*	0,66	0,00	0,02	*0,68*	0,03	0,00	0,01	0,02	0,01	*0,07*	**2,29**
Italy	0,27	0,01	0,01	0,05	0,04	*0,38*	0,34	0,00	0,00	*0,34*	0,01	0,00	0,01	0,03	0,01	*0,06*	**0,79**
Cyprus	0,00	0,00	0,00	0,06	0,00	*0,06*	0,04	0,00	0,00	*0,04*	0,04	0,01	0,01	0,04	0,00	*0,10*	**1,22**
Latvia	0,00	0,00	0,00	0,30	0,00	*0,30*	0,60	0,00	0,00	*0,60*	0,05	0,01	0,25	0,03	0,00	*0,34*	**2,46**
Lithuania	0,00	0,00	0,00	0,28	0,00	*0,28*	0,52	0,00	0,02	*0,54*	0,05	0,27	0,29	0,01	0,04	*0,66*	**2,79**
Lux	0,10	0,00	0,00	0,07	0,00	*0,17*	0,13	0,00	0,00	*0,13*	0,06	0,02	0,15	0,07	0,01	*0,31*	**4,79**
Hungary	0,00	0,00	0,00	0,08	0,00	*0,08*	0,27	0,00	0,00	*0,27*	0,02	0,00	0,08	0,02	0,00	*0,12*	**0,95**
Malta	0,00	0,00	0,00	0,06	0,00	*0,06*	0,15	0,00	0,00	*0,15*	0,06	0,00	0,01	0,02	0,00	*0,09*	**1,77**
Netherland	0,09	0,11	0,00	0,01	0,08	*0,29*	0,08	0,00	0,00	*0,08*	0,01	0,00	0,01	0,06	0,01	*0,09*	**0,47**
Austria	0,26	0,02	0,00	0,20	0,01	*0,49*	0,14	0,00	0,00	*0,14*	0,01	0,00	0,01	0,03	0,01	*0,06*	**0,70**
Poland	0,00	0,01	-0,01	0,15	0,01	*0,16*	0,44	0,00	0,00	*0,44*	0,02	0,00	0,05	0,02	0,00	*0,09*	**1,42**
Portugal	0,36	0,02	0,00	0,15	0,10	*0,63*	2,39	0,00	0,24	*2,63*	0,02	0,00	0,01	0,03	0,01	*0,07*	**3,34**
Slovenia	0,00	0,00	0,00	0,19	0,00	*0,19*	0,09	0,00	0,00	*0,09*	0,02	0,00	0,17	0,03	0,00	*0,22*	**1,08**
Slovakia	0,00	0,00	0,00	0,12	0,00	*0,12*	0,35	0,00	0,00	*0,35*	0,02	0,01	0,05	0,01	0,00	*0,09*	**1,15**
Finland	0,30	0,06	0,00	0,22	0,01	*0,59*	0,24	0,00	0,00	*0,24*	0,01	0,00	0,00	0,05	0,00	*0,06*	**0,91**
Sweden	0,22	0,02	0,00	0,06	0,01	*0,31*	0,15	0,00	0,00	*0,15*	0,01	0,00	0,00	0,04	0,00	*0,05*	**0,52**
UK	0,19	0,02	0,00	0,01	0,02	*0,24*	0,13	0,00	0,00	*0,13*	0,00	0,00	0,00	0,03	0,00	*0,03*	**0,41**
EU	**0,29**	**0,03**	**0,00**	**0,05**	**0,05**	***0,42***	**0,31**	**0,00**	**0,03**	***0,34***	**0,01**	**0,00**	**0,01**	**0,03**	**0,00**	***0,05***	**0,89**

Source: (European Commission,2005) and author's calculations

The country that received most of this "productive" investment in 2004 was Portugal (2.7 % of its GNI), followed by Greece (1.8 % of GDI) and Spain (1.3 % of GNI). Among the new EU-10, the three Baltic countries benefited the most, but they still received only 0.5–0.6 % of their GNI in productive investment. Other countries received less than 1 % of GNI, the lowest beneficiaries being Denmark, the Netherlands, Cyprus, Slovenia and the UK, each of which received only 0.1–0.2 % of GNI in productive investment from the EU budget.

We finally combine these two inputs – taxes paid and capital investments received – to calculate the total effect of the EU budget on economic growth in the EU-25. The results are summarized in *Figure 4*. Five countries of the old EU-15 are estimated to gain a positive growth impulse from the EU budget: Portugal, Greece, Spain, Italy and Ireland. The remaining ten countries suffer a negative effect, ranging from a negligible number in Finland to a –0.06% effect for the Netherlands. Among the new EU-10, the three Baltic countries get a 0.1% boost due to EU budget transfers. Poland, Slovakia, Hungary, the Czech Republic and Malta are in the neutral region: their performance is unchanged after the transfers. Slovenia and Cyprus may suffer a (very limited) setback to their growth rate.

It should be repeated here that these effects account for only the direct budgetary effects of the European Union. We do not take into account the effects of stronger competition from within the single market, nor do we account for macroeconomic policies on the EU level. On the other hand, our results should not be dismissed out of hand. The annual boost of 0.6 % for the Portuguese economy adds 6 % to the economy over a decade, a sizeable effect. Other "southern" countries – Greece and Spain and to some extent also Italy – also received a boost.

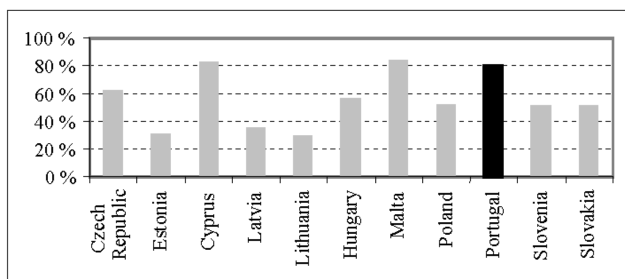
However, if we take the European Union as a single entity, its growth potential is unaffected by its budget. In 2004 the EU-25 countries paid on average (GNI weighted) 0.9 % of GNI in taxes to the budget. They received, on the other hand, 0.89 % of GNI from the EU budget, but only 0.38 % could be classified as "productive investment" contributing to higher competitiveness of the EU economy (with all the caveats applied above). Thus, taken together, the EU budget may spur the EU's growth by a statistically insignificant 0.023 % a year. It is fair to argue that such a miniscule effect is negligible and that there is probably no EU-wide economic effect from the EU budget.

However, one remark is due in this context. If we applied the same methodology to any national budget of an EU member country, the effect would be much worse, as all countries devote a major part of their budgets to redistributive programs that would not qualify as "productive" in the Tanzi and Chalk methodology.

6. The New Member States' Position

This chapter deals with the potential impact of the new financial perspective for the period 2007–2013 on the new member states (NMSs). The NMSs are all certain to remain net beneficiaries of the budget, but they will have to compete for funds not only with the current Objective 1 countries (Portugal, Greece, Spain), but with many other "phase-in" and "phase-out" regions. As *Table 5* shows, the biggest beneficiaries will be the three Baltic countries and Poland, which are expected to receive net transfers of around 4 % GNI annually. Hungary, Slovakia and the Czech Re-

FIGURE 5 Share of Productive Investment (% of total spending)



Source: author's calculations

public should benefit to the tune of 3 % GNI annually, while Slovenia will receive the lowest transfers (between 1 % and 2 % of GNI).

The crucial factor, however, is how the member countries use the funds transferred from the EU budget, i.e. whether they use them for "productive investment" in line with Tanzi and Chalk or whether they waste them by financing purely redistributive programs. The old member countries differ to a large extent in their ability to channel EU funds towards more productive investment. By definition, countries receiving structural funds should enjoy higher productivity effects. Indeed, 80 % of EU funds spent in Portugal can be classified as "productive". This share, though, falls to 60 % for Spain and to 42 % in another big recipient – Greece. As we illustrated, the new member states do not reach this high productivity level, as most of their transfers are "compensation" payments geared towards general budgets. *Figure 5* shows that the new member states receive the bulk of their budgets from the compensation programs.

If we make the "reasonable" assumption that the NMSs, in the medium term, will not be as efficient as Portugal but they will increase their share of productive investment to some 50 % of total EU transfers, they may expect a boost to their growth rate of some 0.5 % for the Baltic countries and Poland, 0.4% for the three central European countries (Hungary, Slovakia and the Czech Republic) and 0.3 % for Slovenia.

The impact of European Union membership is not, however, limited to budgetary transfers. Especially for the new members, EU membership is supposed to accelerate their convergence with the higher income countries. As our estimates in the previous section suggest, EU membership (and the capital investment it brings) may increase a country's growth rate. In this respect, it matters more whether the EU will complete the single market, improve its macroeconomic framework and boost investment in human capital than whether the new financial perspective will direct more or less capital investment to the NMSs.

Nevertheless, the budget may support the NMSs' convergence. In this respect, the new financial framework for 2007–2013 may play an important role in redirecting funds from non-productive programs, such as the CAP, to a more pro-growth agenda. The Commission set a very ambitious goal of increasing investment in research and development, which should reach € 80 billion over seven years. For this investment to be successful, however, a functioning system of EU-wide coordination must be set up in order to select the best projects and avoid duplications.

The new member states face a challenging dilemma in this respect. As they are to gain most from the EU acceleration, they should be supporting the reallocation of funds to research and development. Also, their agricultural lobbies are less organised and less "corrupted" by the CAP, so elimination of some CAP subsidies would face weaker opposition. Thus, the NMSs should join countries such as the UK and the Netherlands and accelerate the CAP reduction in order to make room for more productive investment.

On the other hand, the NMSs would most probably benefit less than proportionally from a reallocation. Their research and development capacities do not guarantee that they would qualify for a proportional part of the funds spent. Moreover, the NMSs tend to have proportionally larger agricultural sectors, so they stand to gain more from the (unreformed) CAP, once its most striking bias is eliminated. Thus, from this point of view, short-term budgetary logic should lead the NMSs to support France and the EU's "Mediterranean wing".

The NMSs' position on the UK's rebate is much more straightforward: they stand to gain from the elimination of the UK's rebate, even if it is substituted by the Commission's proposal of a generalized correction mechanism (see *Table 4*). Thus, if the EU leaders opted for a grand "zero", i.e. joint elimination of the rebate and substantial reduction in CAP spending, the new member states should celebrate.

7. Conclusion

The European Union finds itself in a fascinating period. The great push for more integration and enlargement in the 1990s has led to some fatigue within the EU. In response to this, the EU has set out to streamline its governance and to re-focus towards growth-friendly activities. The Union's financial framework for the 2007––2013 period reflects these conflicts. On the one hand, all the member countries are obsessed with limiting their net contributions to the budget. On the other hand, no country seems to be prepared to give up its own pet projects on the spending agenda. Add to this ten newcomers trying to muscle their way to funds from the EU and the mixture becomes very combustible.

Nevertheless, even in this flux, the EU authorities and their masters in the national governments should seek an economically efficient framework for the new financial perspective spanning the period 2007–2013. Both the European Commission proposal and the Lisbon agenda provide some useful guiding principles. First, the EU budget should limit its non-productive spending, mostly on the Common Agricultural Policy. The CAP has been nudged towards yet another redistributive policy that is better run at the national level. For example, the 2004–2006 co-financing of EU budget transfers to farmers in the new member states represents a first attempt at introducing a national co-financing mechanism into the CAP and should be extended.

Second, the European budget may increase its convergence role by concentrating more on poor member states. In this respect, the dilution of the structural funds' focus on poor member states, as envisaged in the new financial perspective, is counterproductive. The EU should consider moving towards a more generalized model whereby richer countries would support poorer ones through a system of redistributive grants among countries. Such a generalized system would end the cur-

rent anomaly where the two richest member states – Luxembourg and Ireland – are also the biggest net recipients of EU funds.

Last, but perhaps not least, the EU may play a useful catalytic role in financing some areas with potential economies of scale or high public good or externality effects. These may include research and development (including international training and education, where Erasmus is planned to take 40 % of the education budget, i.e. € 14 billion) and infrastructure programs. The new member states may play a useful role in the EU budget negotiations if they help to bring about a substantial change in the budget. The EU budget as it is now represents a neutral factor for most countries and it will accelerate the new member states' economies only marginally. Given the attention, effort and time given to the budget, it is not good value for their money.

REFERENCES

Backé P (2002): Fiscal Effects of EU Membership for Central European and Baltic EU Accession Countries. *Focus on Transition*, ONB, no. 2, (Vienna).

Baldwin R (2005): The Real Budget Battle. *Centre for European Policy Studies, Policy Brief*, no. 75, June 2005 (Brussels).

Barro R (1991): Economic Growth in a Cross-Section of Countries. *Quarterly Journal of Economics*, MIT Press, Cambridge, MA.

Buti M, Hagen J von, Martinez-Mongay C (2002): *The Behaviour of Fiscal Authorities – Stabilization, Growth and Institutions.* Palgrave, New York.

Dall'erba S, Le Gallo J (2007): The Impact of EU Regional Support on Growth and Employment. *Finance a úvěr-Czech Journal of Economics and Finance*, 57(7-8):325–340.

Ederveen S, de Groot HLF, Nahuis R (2002): Fertile Soil For Structural Funds? *Tinbergen Institute Discussion Papers*, 02-096/3, Tinbergen Institute.

European Commission (2004A): *Building Our Common Future – Policy Challenges and Budgetary Means of the Enlarged Union 2007–2013*. European Commission, Brussels, Communication from the Commission, February 2004.

European Commission (2004B): Public Finances in EMU 2004. European Commission, Brussels, *European Economy Reports and Studies*, no. 3.

European Commission (2004C): *Financing the European Union, Commission Report on the Operation of the Own Resources System.* July 2004, European Commission, DG III, Brussels.

European Commission (2004D): *Allocation of 2003 EU Operating Expenditure by Member State.* September 2004, European Commission, DG III, Brussels.

European Commission (2004E): *Proposal for a Council Regulation on the Implementing Measures for Correction of Budgetary Imbalances.* August 2004, European Commission, 2004/0170, Brussels.

European Commission (2005): *Allocation of 2004 EU Operating Expenditure by Member State*. September 2005, European Commission, DG III, Brussels.

Federal Office for Building and Regional Planning (2004): *Convergence and Competitiveness – Potential Objective 1 Regions in the European Union after 2006.* Berlin, September 2004.

Gleich H (2003): Budget Institutions and Fiscal Performance in Central and Eastern European Countries. *ECB Working Paper*, no. 215.

Hallet M (2004): Fiscal Effects of Accession in the New Member States. *European Economy, Economic Papers,* no. 203 (May).

Hallet M, Keereman F (2005): Budgetary Transfers Between the EU and the New Member States. *Economic Analysis from the European Commission*, 2,(2-February).

Hallett AH, Lewis J, Hagen J von (2004): F*iscal Policy in Europe 1991–2003: An Evidence-based Analysis*. CEPR, 2004.

House of Lords, European Union Committee (2005): *Future Financing of the European Union.* Authority of the House of Lords, London.

Kneller R, Bleany M, Gemmel N (1999): Fiscal Policy and Growth: Evidence from OECD Countries. *Journal of Public Economics*, 74(2):171–190.

Kopits G, Szekely IP (2002): *Fiscal Policy Challenges of EU Accession for the Baltics and Central Europe*. Paper presented at an Austrian Central Bank conference in Vienna, 3–5 November 2002.

Mayhew A (2003): The Financial and Budgetary Impact of Enlargement and Accession. *Sussex European Institute, Working Paper,* no. 65.

Mayhew A (2005): The Financial Framework of the European Union 2007–2013: New Policies? New Money? *Sussex European Institute, Working Paper*, no. 78.

Mendoza E, Milesi-Feretti GM, Asea P (1997): On the Ineffectiveness of Tax Policy in Altering Long--Term Growth – Herberger's Superneutrality Conjecture. *Journal of Public Economics*, 66:99–126 (Elsevier).

Morgensen UB, Lenain P, Royuela-Mora V (2005): The Lisbon Strategy at Midterm: Expectations and Reality. *CASE Report*, no. 58, CASE, Warsaw.

Perotti R, Strauch R, Hagen J von (1998): Sustainable Public Finances. *CEPR Discussion Paper,* no 1781, 1998.

Schneider O, Zápal J (2006): Fiscal Policy in New EU Member States – Go East, Prudent Man! *Post-Communist Economies*, 18:139–166.

Sapir G et al. (2003): *An Agenda for a Growing Europe: Making the EU Economic System Deliver*. Report to the President of the European Commission, July 2003, Brussels.

Sapir G et al. (2004): *An Agenda for a Growing Europe: The Sapir Report*. Oxford University Press.

Editorial Note

The editors and the office of the "Czech Journal of Economics and Finance--Finance a uver" would like to express sincere regret to our readers for attributing the paper "Cohesion Policy, the Convergence Process and Employment in the European Union", published in the 2007/3-4 issue on pages 126–141, to Boris Gramc. The paper was, in fact, written by Sandy Dall'erba from the University of Arizona (USA) and Julie Le Gallo from the Université de Franche-Comté (France) and it was submitted to our journal by Professor Gramc without their knowledge or consent. Professors Dall'erba and Le Gallo have graciously agreed to publish their paper in our journal and we are printing an updated version in this issue of the journal under their names, titled as "The Impact of EU Regional Support on Growth and Employment".

We sincerely apologize to both authors and ask our readers to ignore the version published under the improper title and credits. We also ask libraries and electronic databases to delete the paper "Cohesion Policy, the Convergence Process and Employment in the European Union" published on pages 126-141 from the list of papers published in 2007.