Communication from the Commission entitled Reforming the budget, changing Europe (12 September 2007)

Caption: On 12 September 2007, the European Commission adopts a public consultation document entitled ‘Reforming the budget, changing Europe’ on the European Union budget review due to be undertaken in 2008–2009. This communication suggests avenues which might be explored concerning the changes to be made in terms of both expenditure and revenue.

Source: Communication from the Commission "Reforming the budget, changing Europe", A public consultation paper in view of the 2008/2009 budget review SEC(2007) 1188 final. Brussels: Commission of the European Communities, 12.09.2007. 13 p. http://ec.europa.eu/budget/reform/library/issue_paper/consultation_paper_en.pdf.

URL:
http://www.cvce.eu/obj/communication_from_the_commission_entitled_reforming_the_budget_changing_europe_12_september_2007-en-3cb41400-95be-4bb5-9a42-1c5e58b34476.html

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Communication from the Commission entitled “Reforming the budget, changing Europe” – A public consultation paper in view of the 2008/2009 budget review

Introduction

A Comprehensive Review of Spending and Resources

In May 2006, the European Parliament, the Council and the Commission agreed that the Commission should undertake a fundamental review of the EU budget. The Commission was invited

"to undertake a full, wide ranging review covering all aspects of EU spending, including the CAP, and of resources, including the UK rebate, to report in 2008/9"[1].

The European Union's policy agenda is in a phase of profound modernisation. Globalisation has brought about new challenges and issues like climate change, energy and migration have come to the centre of the European debate. Innovation, skills and the right business environment are more than ever at the core of the growth and jobs strategy. Citizens' desire to see European interests and European values projected worldwide has never been stronger. Enlargement has reinforced the need to promote social, economic and territorial cohesion.

The budget is an important lever for the EU to deliver existing policy goals, to bring about change and to maximise the long-term impact of EU action. Twenty years after the first financial framework, it is time for a Europe-wide reflection preparing the ground for a renewed consensus about the direction of EU spending policies able to meet the challenges of the next decade and beyond.

The budget review is a unique opportunity for a thorough assessment of the EU budget and its financing, free from the constraints of a negotiation on a financial framework. It will take a long time horizon, to see how the budget can already be shaped to serve EU policies and to meet the challenges of the decades ahead. It will therefore not propose a new multi-annual financial framework for the period from 2014 – this task will be for the next Commission – nor the overall size and detailed breakdown of the EU budget. It will rather set out the structure and direction of the Union's future spending priorities, assessing what offers the best added value and most effective results. It will also examine how the budget works, how to get the right balance between continuity and responding to new challenges, and whether it should be managed differently. Finally, the review will take a fresh look at the best way of providing the resources necessary to fund EU policies.

Preparing the Review

The aim of this paper is to launch a broad consultation with interested parties at local, regional and national levels, as well as at the European level, to stimulate an open debate on EU finances.

Section 1 puts the EU budget in perspective and shows how the budget can be used as a tool to reflect changing political priorities. Section 2 presents some key elements for exploring how a modernised EU budget can provide the greatest added value in meeting the long-term challenges facing the Union. Section 3 deals with the financing of the budget.

The consultation will form an important basis for the Commission's work on the review. It will be complemented by preparatory action in key spending areas where the Union has made a major investment and where effective use of the budget is particularly important to the success of the policy. The Common Agricultural Policy will undergo a "health check" to fine-tune the 2003 reforms and contribute to the discussion on future priorities in the field of agriculture. The fourth Cohesion Report adopted in May looked at progress in reducing regional disparities and evaluated the results of Cohesion Policy to date. Reviews will also take place in other policy areas. These policy assessments are intended to check whether policies are working as they should in a Union of 27 Member States. In some instances they will lead to immediate adjustments, but they will also feed into the longer-term perspective of the review. In addition, the

Commission has engaged in a dialogue with a number of distinguished academics and launched a series of horizontal and sectoral studies to enrich the results of the consultation. With the help of its Representations in the Member States, it will accompany the consultation process by encouraging and supporting discussion at the national, regional and local level.

As set out in the Inter-institutional Agreement of May 2006 setting up the current financial framework the European Parliament will be associated with the review at all stages of the procedure and the review will also be accompanied by an assessment of the functioning of the current Interinstitutional Agreement.

This consultation invites input to the Commission's budget review 2008-2009, which will itself be the subject of a fundamental debate in the EU institutions and the Member States. The Commission's approach is one of openness and no taboos: it will prepare this review with no preconceptions and encourages all interested parties to contribute to the consultation.

The consultation process

Submissions should be sent to budget-review@ec.europa.eu *by* 15 April 2008 at the latest. Where longer submissions are considered necessary, they should be accompanied by a summary. Submissions will be published on the website http://ec.europa.eu/budget/reform/index_en.htm unless the senders concerned have explicitly objected to the publication of their contribution[2]. The Commission will publish comments received on this website in the format in which they are received. These should therefore not contain confidential information.

The key messages and trends conveyed in the contributions will be presented at a large-scale conference to be organised after the end of the consultation period. They will also appear on the Commission's website on the review of the multi-annual financial framework http://ec.europa.eu/budget/reform/index_en.htm.

1. The EU budget from its beginnings

1.1. A Budget to Deliver Policy Objectives

The EU budget is much misunderstood. It is at the same time large in absolute terms (over € 100 billion per year) and small as a percentage of total EU public expenditure (less than 2½ %). It has been the source of periodic political crises, yet has also acted as a vector of stability for the development of the EU, framed over successive financial frameworks since the 1980s. Over this period, the budget increased in real terms but its relative size to GNI has shrunk, even though the Union has enlarged and taken on new policy responsibilities.

[Graph on relative size of EU budget]

The budget has proved a key instrument to realise the EU's policy objectives. It represents an investment to further Europe's goals – and citizens expect and deserve the best possible return for that investment. This means ensuring that the budget is targeted to best effect, managed to the highest standards, and that it succeeds in bringing tangible improvements to the daily lives of citizens. That means a budget able to change to reflect changing priorities, and to accompany the process of European integration as it evolves.

EU spending must be coherent with other actions to deliver Europe's policy agenda and take its place amongst the range of instruments available, such as legislation, removing regulatory barriers, influencing national spending, policy coordination or the exchange of ideas, best practice and peer reviews. Not all policies require EU spending – beyond basic administrative costs. Core policies like trade and competition achieve their goals with different instruments and will have little or no relevance for the review of the multi-annual financial framework. For other policy areas, the deployment of financial resources is central to the realisation of their objectives – such as in the case of cohesion policy or student mobility.

Financial support generated by EU policies can take various forms and draw on various sources, including loans and loan guarantees from the European Investment Bank, or Member State budgets in the case of co-financing, as well as private funding in public-private partnerships. Where the EU budget has been used, it has had to show itself to be the most efficient and equitable instrument to deliver results.

1.2. The Budget as a tool for changing priorities

EU policies have seen huge changes over past decades, and the budget has sought both to promote and reflect that evolution.

The EU budget has mirrored the key steps of European integration. The Single Market, enlargement, the growth of a global vision for Europe – such developments have always required shifts in the pattern of EU spending. 2008 will see another step in this path, as for the first time, policies specifically geared to growth and jobs will take the largest share of the EU budget.

The profile of EU spending has changed considerably over time: historically, the vast bulk of the EU budget has been concentrated in a relatively small number of policy areas. But both within and beyond these areas, the focus of spending and the policy objectives pursued have evolved. Budget reform always faces an inbuilt conservatism. But despite the political challenge of budget reform, significant changes and reorientations have been possible – even if the speed of response has sometimes lagged behind.

The structure of the budget as well as its size has continuously evolved:

• At the beginning of the integration process, each of the three European Communities had specific budgets. The first budget of the European Economic Community (EEC) was very small and covered exclusively administrative expenditure. The 2007 general budget is mainly an operating budget, authorising payment appropriations at a level of € 115.5 billion for sustainable growth, the preservation of natural resources, citizenship, freedom security and justice and the Union's external action.

• In 1965, payments for the Common Agricultural Policy (CAP) absorbed 35.7% of the budget and rose to 70.8% in 1985. In the first year of the 1988-1992 financial framework, CAP expenditure still represented 60.7% of the budget. By 2013, the share of traditional CAP spending (excluding rural development) will have almost halved (32%), following a decrease in real terms in the current financing period.

• Only 6% of the European budget was spent on cohesion policy in 1965, a share which increased only slightly until the 1980s (10.8% in 1985). The Single European Act put a new emphasis on economic and social cohesion and was accompanied by a significant increase of cohesion spending. The amounts earmarked for structural actions had already risen to 17.2% by 1988, and will represent 35.7% of the EU budget in 2013, with at least two-thirds earmarked for competitiveness, growth and jobs.

• Funding for other policies (mainly related to competitiveness, external actions and rural development) was originally very limited. In the first financial framework only 7.3% of the budget was reserved for these areas. But the new emphasis on economic development and competitiveness will see the share of such policies rise to 26% in 2013, of which 10.2% for competitiveness, 6.3% for external actions and 7.3% for rural development.

[Graph on expenditures structure (1988-2013)]

The spending policies for the period 2007-2013 put a new emphasis on the goals of growth and employment and on new policy directions such as freedom, security and justice. At the same time, the decision to undertake a review acknowledged that a more fundamental assessment is needed, to offer a long-term context to inform proposals for the next financial framework and beyond. The challenge is to develop a budget for the future, anticipating tomorrow's challenges in a world of rapid change.

As well as the evolution of the budget from one financial framework to the next, there is also an issue of flexibility inside each financial framework. Whilst some spending programmes benefit from continuity, changing political circumstances can also test the ability of the EU budget to adapt to best effect and to enhance political responsiveness.

• *Has the EU budget proved sufficiently responsive to changing needs?*
• *How should the right balance be found between the need for stability and the need for flexibility within multi-annual financial frameworks?*

2. Shaping the EU budget of the future: the added value of EU spending

Public spending at European level – as at national and local level – must give citizens confidence that it is focused on their own priorities and that the funds entrusted to the EU are well spent. Financial discipline continues to impose strict limitations on public spending at all levels. EU spending must therefore be based on an assessment of the added value of the different aspects of EU spending.

Different elements determine whether EU spending meets the added value test. It has a political nature – for example, to show solidarity, to increase visibility, and above all to further the Union's key policy objectives. It must be able to offer a return at European level which could not be matched by national or local spending. It must be organised in such a way that the spending meets its goals.

Optimising EU spending is therefore about choices, and about concentrating resources where they generate the highest benefit. The budget review 2008-2009 should help in making these choices and determining spending priorities: there may be policy areas where European spending is no longer needed or where its return is limited; on the other hand, there may be new and cross-cutting policy priorities which call for new resources. At the same time, the need to complete ongoing activities and to continue funding policies which deliver good results will also have to be taken into account.

2.1. Preparing for Tomorrow's Challenges

Over the past two years, the European Union has increased the pace of change, developing a forward-looking policy agenda which will determine the Union's key focus into the next decade and beyond. It is possible to sketch out the new policy challenges which could have a significant impact on where the Union directs its efforts in the future:

• Europe has to promote its values against a background of growing *diversity and change*, and in an ever more complex global environment. Competition for resources and markets has become more intense. The economic balance of power is changing. The opening up of huge new markets creates vast new opportunities for Europeans, but it will at the same time test Europe's *capacity to further adjust to structural change* and manage its social consequences.

• Globalisation is driving *scientific and technological progress*, making the European dimension ever more important in boosting *knowledge, mobility, competitiveness and innovation*. The EU can help to galvanise the advantages of its continental scale to promote excellence and carry it through into growth.

• The transformation to a *knowledge and service economy* is as profound as the earlier switch from agriculture to industry. It is reshaping the nature of work. Information technology and personal skills are in huge demand. Too many young people – one in six – are still leaving school early and even more lack the basic skills needed in the knowledge economy.

• Birth rates at present levels will change the *structure and balance of our societies*, raising important issues of both economic efficiency and inter-generational equity. Appropriate responses are needed to promote demographic renewal, longer working lives of better quality, a more productive and dynamic Europe, the integration of migrants as well as the sustainability of public finances. Child care and work life balance issues around the support for the increasing number of "dual earner" families are also important in that respect.

• *Solidarity* and Europe's commitment to social justice represent an important dimension of the European way of life in a globalised world. The EU has used its budget as a tool to promote economic development in its less-developed regions to good effect, but the increased disparities following enlargement underline the importance of *economic and social cohesion* and raise questions about the way in which the budget can best be used to promote solidarity. Between 1988 and 2007, enlargement has increased the population of the EU by 50%. In 1988, four Member States out of 12 had a GDP per capita below 75% of the EU average. Two decades later, 10 Member States out of 27 are in the same position, and 7 of them have GDP per capita below the level of the poorest Member State in 1988.

• The impact of *climate change* on Europe's environment and its society has become central to the European agenda, challenging policymakers to reflect on how best to respond with the policy instruments at the EU's disposal. This applies both to efforts to mitigate climate change by tackling the growth in greenhouse gas emissions, and the need for measures to adapt to the consequences of climate change.

• The pressures of climate change on the rural and marine environment come together with demographic change and evolving demands from consumers to bring a new dimension to the European Union's policies on Europe's agriculture, countryside, *rural society* and maritime areas.

• Secure, sustainable and competitive *energy* represents one of society's main challenges. Limited supply, increased global demand and the imperative to cut emissions have led to a new realisation of the need to create a true low-carbon economy in Europe.

• *Migratory pressure* will affect Europe particularly strongly, due to its proximity to the world's poorest regions and those likely to be worst affected by climate change. The increasingly difficult situation on our southern and eastern borders will require a forceful European response combining secure borders, innovative ways of managing migration as well as convincing efforts to address the root causes of migration: war, instability and poverty.

• The European dimension continues to be ever more central to the task of providing *security and safety* to citizens – whether through combating crime and terrorism, or containing risks to transport, the environment, health and safety. New security threats are more diverse, less visible and less predictable. The mix of instruments needed to provide effective European responses in these areas implies a careful combination of different actors and different tools.

• Globalisation has brought home the need for Europe to have an effective *presence worldwide* if it is to project its interests and values successfully. Enlargement and the strengthening of mutual solidarity have made the Union a more credible and effective actor on the world stage. At the same time, the global context has changed. The world has become more inter-dependent, making Europe's strong efforts for a stable and prosperous neighbourhood, for effective multilateralism, for human rights and the rule of law, as well as its leadership in the fight against poverty not only a matter of principle, but a vital necessity. Distinctions between domestic and external policies are disappearing and cross-cutting core policies like addressing climate change and biodiversity, demographic change and migration, competitiveness, terrorism and organised crime, or energy needs can only be tackled in an international context.

It is essential that the EU's policy levers are geared to face these – and other – new challenges. Financial resources will inevitably be an important part of the policy mix needed to deliver on the expectations of our citizens. Most of the necessary funding will not come from the EU budget but this can have an important role if targeted to galvanise change effectively.

2.2. The balance between European and national spending

In the budget as elsewhere, European action should provide clear additional benefits compared to action by individual Member States alone in pursuing policies that promote the European common interest.

Subsidiarity and proportionality are therefore core criteria to determine the added value of EU spending.

Under the principle of subsidiarity, the Union shall act only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level. Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve its objectives. The choice of an instrument is proportionate if it is the least intrusive tool available to achieve a specific objective.

The case for spending from the EU budget on these grounds is made if this is the most efficient policy lever available to provide the appropriate response to a given problem. Subsidiarity and proportionality therefore require an assessment of the factors which will allow a policy to succeed, such as its transnational dimension, the potential for economies of scale or scope, critical mass requirements, local preferences, coordination costs and other political circumstances.

2.3. Delivering EU Policies

European policies need effective and efficient delivery to secure the necessary added value. The institutions, and in particular the Commission, are accountable for the use of financial resources. They need to be able to demonstrate that the budget is managed according to the highest standards and that effective and efficient delivery mechanisms are in place.

Key issues arising in this context are:

• **The balance between spreading support between a range of activities and concentrating the funds available:** Concentration on fewer policy goals could allow for economies of scale and, in some cases, save money from the national budgets. However, this approach would deprive other areas of financial support.

• **The balance between centralised and decentralised management:** EU funds are currently implemented through various management methods. Some 22% are managed centrally, by the Commission; the management of around 76% of funds is delegated to Member States by the Commission, under "shared management"; the rest is managed with international organisations or by third countries. With the policies evolving, a fresh look needs to be taken to determine how different types of management can offer sound financial management and whether the existing balance represents the right answer.

• **Enhanced simplification and strengthened delivery instruments:** The start of the new financing period at the beginning of this year has seen a considerable simplification of the structure of the EU budget and the budget's delivery instruments, with programmes reorganised to help meet the principle of "one programme, one fund", and a new balance between user-friendliness of EU programmes and sound financial management. Cost-effective delivery and coherence between programmes are central to delivering added value.

• **Leveraging resources:** The choice of management method helps to determine the extent to which the EU budget can leverage extra resources, whether through other EU instruments such as the European Investment Bank, through national, regional and local public spending, or through private sector contributions.

• **The use of executive agencies:** The possibility to set up executive agencies entrusted with certain management tasks for funds implemented directly by the Commission made it easier to use specialised staff for certain management activities, added to the visibility of programme management and offered economies of scale. Yet it also raises questions about the optimal balance between policy and management tasks within the institutions.

• **Co-financing:** Co-financing is an example of partnership between regional, national and Community action in pursuit of EU policies. It increases ownership and gives an added incentive to ensure complementarity between EU and national action. Compulsory co-financing at Member State level is a key feature of the Union's structural and rural development policies, which, taken together, account for over 40% of spending in the current financing period.

• **Ensuring full transparency, visibility and accountability in the management of the budget**, to ensure legitimacy, and citizens' confidence in the European Union.

A linked issue is **flexibility**. Sound financial management could be enhanced through greater flexibility, allowing resources to be reallocated between or within budget headings. This could help to shift support to the highest-performing programmes in terms of cost-effectiveness and criteria such as observed absorption capacity.

• Do the new policy challenges set out here effectively summarise the key issues facing Europe in the coming decades?
• What criteria should be used to ensure that the principle of European value added is applied effectively?
• How should policy objectives be properly reflected in spending priorities? What changes are needed?
• Over what time horizon should reorientations be made?
• How could the effectiveness and efficiency of budget delivery be improved?
• Could the transparency and accountability of the budget be further enhanced?
•Could enhanced flexibility help to maximise the return on EU spending and political responsiveness of the EU budget?

3. Financing the budget

3.1. The EU Own Resources System

Total EU revenue has to be equal to total expenditure and is required to stay within agreed legal limits, currently 1.31% of the EU gross national income (GNI) for appropriations for commitments and 1.24% of EU GNI for appropriations for payments.

The main source to finance the EU budget is now a resource based on the Member States' gross national income. This has grown to surpass the other sources, customs duties and agricultural levies ("traditional own resources"), and a resource based on a value added tax base. The own resources system has evolved significantly since the beginning of the first financial framework. In 1988, the GNI resource made up less than 11% of EU financing, compared to 28% provided by custom duties and agricultural levies and 57% by the VAT-based own resource. In 2013, the GNI resource will provide about 74% of the EU financing, against 13% for customs and agricultural levies and 12% for the VAT-based resource.

[Graph on revenues structure (1988-2013)]

The sources and mechanisms of funding the EU budget should ensure an adequate funding of EU policies. They should be judged against commonly agreed principles such as economic efficiency, equity, stability, visibility and simplicity, administrative cost-effectiveness, financial autonomy and sufficiency. None of the funding sources of the EU budget satisfies all of these principles to the same extent, and it is difficult to conceive an "ideal" funding system. However, the resources structure should seek to comply with the most important funding principles to the greatest possible extent, while minimising negative effects from the perspective of other relevant principles. To achieve that objective, choices have to be made on the principles and their relative importance.

Although the current system has succeeded in providing sufficient resources to finance the EU budget, there is nevertheless a continuous debate about whether the source of funding could be improved in order to better comply with the relevant financing principles. The two largest sources of revenue – the VAT and GNI based own resources – display many of the characteristics of national contributions and are often perceived as such. They are provided by national Treasuries and are sometimes presented as an expenditure item in national budgets. As a consequence, Member States often tend to judge EU policies and initiatives in terms of returns compared to their national contributions, rather than looking first at the overall value of pursuing certain policies at the European level.

The overall composition of the Union's own resources system will thus be an important element to be examined in the context of the review.

3.2. Corrections

In the years since the 1984 Fontainebleau agreement, according to which *"any Member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time"*, several permanent or temporary correction mechanisms have been introduced on the income side. These corrections, which include the UK correction – essentially consisting of the reimbursement of 66% of the difference between UK GNI- and VAT-contributions to the budget and its receipts – lump-sum payments to the Netherlands and Sweden, reduced VAT call-rates for the Netherlands, Sweden, Germany and Austria, as well as a flat rate retention of 25% of traditional own resources for Member States collecting them, have considerably reduced the simplicity and transparency of the system. More importantly, this logic, alongside the increasing focus placed on a narrow 'accounting' approach with the main objective of maximising returns, has led to tensions between Member States and has coloured the public debate about the value of EU spending and the benefits of EU membership itself.

Against this backdrop, the review will take a close look on whether and to what extent the various correction mechanisms which have emerged and their underlying principles are still justified. A consensus on spending priorities could already facilitate a reform of the EU own resources system It is also in this context that possible alternative own resources should be examined very carefully, taking into account the national sovereignty on fiscal policy and, for instance, the cross-border mobility of some tax bases and the impact of such resources on related EU policies.

• ***What principles should underpin the revenue side of the budget and how should these be translated in the own resources system?***
• ***Is there any justification for maintaining correction or compensatory mechanisms?***
• ***What should be the relationship between citizens, policy priorities, and the financing of the EU budget?***

4. Conclusion

The budget review is a real opportunity for the European Union to reflect on how it uses one of its most important tools, one with a direct impact on European as citizens, as consumers of EU-funded services, and as taxpayers. The European Commission invites all actors at local, regional, national and European level to participate in this debate and respond to the issues set out in this paper and thus contribute to reforming the EU budget – and changing Europe.

The results of this large and extended consultation will provide a major contribution to the Commission's own reflections leading up to the presentation of the budget review.

[1] Declaration n° 3 annexed to the Interinstitutional Agreement between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management - OJ C 139, 14.6.2006.
[2] However, as a general rule, comments and contributions received from individuals will only be published on the Commission's website on an anonymous basis, leaving out the sender's name and contact data and specifying only the sender's country of residence. Individual contributors who want the Commission to publish their names and contact data on the website together with the contributions received must explicitly communicate this to the Commission when sending their contributions.