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TIME TO START A SERIOUS BUDGET DEBATE?

OPPORTUNITIES AND PITFALLS OF THE POLISH EU PRESIDENCY FROM THE CZECH PERSPECTIVE

Lubor Lacina

Most of the EU's policies are implemented by its member states, using their own budgets. However, there are certain things that can only be done by having an EU budget – to finance issues that the member states cannot fund on their own or which they can fund more economically by pooling their resources through the EU budget. The EU budget is small (1.01% of EU gross national income[1] – GNI).

"As it stands today, the EU budget is a historical relic. Expenditures, revenues and procedures are all inconsistent with the present and future state of EU integration… The procedure for adopting the EU Financial Perspectives (the multi-annual frameworks, which determine the maximum amount for every item of expenditure in the EU annual budget) is driven by narrow national calculations of self-interest, bolstered by unanimity voting. For these reasons, the successive negotiations to renew the Financial Perspectives for a five or seven-year period have always followed the line of least resistance, which consists of modifying, at the margin only, the financial allocations of the previous period. As a result, the current budget is more the expression of different deals and attempts by governments to claw back in receipts as much of their contribution as possible (juste retour *again!) than a coherent set of measures aimed at pursuing EU objectives."[2]*

The Challenges at Stake

The above statements from Sapir report perfectly describe the current situation in the EU and the position of individual member states toward the size, role and level of redistribution of EU budget. The size of the EU budget which is even growing in absolute terms is, however, fixed in the relative size and there is no long term support to increase it significantly above 1% of EU GNI. On the contrary, both the European Commission and the European Parliament are supporting the increase of the size of the EU budget. The good example is the proposal of the European Commission to increase the ceiling for the EU budget for the financial perspective of 2007–2013. The main difficulty with the Commission proposal, of course, was that the member states did not seem willing to raise the resource ceiling to 1.24%; indeed a number of countries had proposed that the ceiling be lowered to 1%. However, the recent problem of some Eurozone countries did stress again the need to seriously discuss the ability of EU budget to play a sta-

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bilizing role as recommended by MacDougal report back in 1977.[3]

The main challenges while negotiating new Multiannual Financial Framework (MFF) for the period of 2014–2020:

- *Move the discussion from the technical (bureaucratic) point of view to political one. Most of the former and recent discussions about EU budget reform have just technical dimension (how to move resources between different headings without increasing the size of EU budget or even receive the same results with lower budget). But given the degree of economic integration (existence of common currency), the discussion has to be more policy oriented. The decision makers have to take responsibility for a substantial reform of the EU budget that will reflect the latest developments in the Eurozone.*

- *Given the negotiation process of the future Multiannual Financial Framework (MFF) and the role of EU Council, the politicians have to seriously discuss the ability of the member states to agree on a significantly higher ceiling for the EU budget revenues rather than just protecting their net balances and national interests to receive as much as possible in net transfers from the EU budget (juste retour).*

- *Given the size of the already agreed funds which are to be provided to indebted members of the Eurozone, there is a good opportunity to include those funds to the EU budget framework and thus increase the stabilization capacity of the EU budget and make it more relevant to given stage of economic and political integration which the EU reached after the Maastricht Treaty.*

- *Policy makers will have to decide between Scylla and Charybdis. They are both dangerous but the boat called the EU has to pass through. Either strengthens the principle of solidarity via an increased size of the EU budget with all possible negative consequences, such as long-term redistribution of resources (taxes) to problematic states and possible creation of new "Mezzogiorni". The other alternative is to respect the recent status quo and just continue in technical changes inside the recent structure of budget without any significant move towards a budget which would fit the given stage of economic and political integration. The lack of willingness to discuss possible federalization of the EU budget can lead to the situation that further economic and political integration will be limited by an insufficient size of the common budget. Just remember that MacDougall committee report[4] which proposed federalization of the EU budget will soon celebrate 35 years since it was released.*

The Stakeholders' Positions

European Commission

Note: On 29 June, 2011, the Commission proposed certain measures, one concerning the next MFF and the other its own resources.

According to the EC, the goal must be to use the budget as effectively as possible to achieve the EU's objectives.

Some of the key lessons to be learnt to further this objective can be found in the EC proposal "The EU Budget Review", including the following statements[5]:

- *Since their introduction in 1988, the EU's multiannual financial frameworks have ensured a strict budgetary discipline and medium-term predictability of the EU expenditure. This predictability has come at the price of limited flexibility. The past years have shown that the financial framework and its programmes have not always been able to respond to political imperatives and changing circumstances.*

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- *Another of the unforeseen events of recent years has been the economic crisis and its effects on the debate on economic governance. This underlined the interdependence of the EU's economies and the need to strengthen common rules. In the first place, the use of the budget as collateral to support the European stabilisation mechanism showed an innovative use of the budget to support an urgent policy need, however tightly constrained by the ceiling of own resources.*

- *The nature of the debate leading up to agreement on the last financial framework also had consequences for the ability of the budget to deliver. The concentration on the issue of "net balances" (juste retour) meant that programmes were skewed to maximise the ability to put a "national flag" on spending in advance. This was given priority over measures designed to improve performance, such as macro policy dialogue and holding back reserves to reward effectiveness. It also meant that the European dimension – where the EU can bring the highest added value – was not always the primary consideration. The "juste retour" debate therefore had a negative impact on the quality of delivery and reduced the EU added value.*

In the European Commission proposal which was published in June 2011, the European added value (EDV) is stressed. It is defined as follows: "*On a general level, European added value is the value resulting from an EU intervention which is additional to the value that would have been otherwise created by Member State action alone.*"[6] In this point the position of European Commission is in keeping with the European Parliament which defines EDV as "*the concept of European added value must not be limited to advanced cooperation between Members States but should also contain a visionary aspect*".[7]

European Parliament

The European Parliament has issued a challenge to the member states that want to freeze the EU's next long-term budget covering the period 2014–2020. These countries should spell out which priorities they would drop as a consequence of the freeze. If all the objectives and policies agreed for the EU are to be completed, a minimum increase of 5% is needed, compared to the 2013 budget.

"*The new financial perspective needs to reflect the EU 2020 strategy and other agreed policies. When we are asking for increases, it is not because we are inventing things. We just want a realistic and implementable budget,*" added Jutta Haug (S&D, DE), chair of the Parliament's Special Committee on Policy Challenges, which had worked for a year to produce the report.

MEPs feel that freezing future budgets at the 2013 level "*is not a viable option*". An increase of at least 5% over the 2013 level – as they propose – would mean that the EU budget would be roughly 1.11% of the EU's total GNI, compared to the 1.06% expected for 2013. MEPs urge the member states that advocate a frozen or reduced long-term budget to state exactly which policy priorities they want to drop in order to make room for a budget cut. The parliament fears that budget restrictions could jeopardise the already agreed boost for research and innovation (from today's 1.9% of GDP to 3%) as well as investment in infrastructure, foreign policy and enlargement.

Regional policy (cohesion and structural funds) and farm spending should remain at current levels, says the resolution. Regarding regions whose GDP per capita stands at between 75% and 90% of EU GDP, MEPs urge the Commission to establish an intermediary category for the next budget period to give these regions a clearer status and more security in their development. Furthermore, investment in energy infrastructure should go up. Savings could possibly be made on the EU administration.

MEPs also criticise the current funding system, which relies almost entirely on national contributions and has become extremely complex. The EU Treaty says that the EU-budget "*shall be financed wholly from own resources*". The current funding method places disproportionate emphasis on net

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balances between the member states, contradicting the principle of the EU solidarity, diluting the European common interest and largely ignoring the advantages of financing policies at the EU level, they argue. A system of actual own resources would be "*fairer, more transparent, simpler and equitable*", say MEPs, whilst stressing that a budget reform does not necessarily have to affect the size of the budget and would not increase the overall tax burden on citizens. They also call for an end to the "*rebates, exceptions and correction mechanisms*" that have accumulated within the current system.

According to the European Parliament, another important problem with the current MFF is the lack of flexibility it allows within annual budgets. If something new or unexpected comes up, it is hard to adapt the budget to accommodate it. This is fully consistent with the position of the European Commission that used several examples to show inflexibility of the EU budget to react to unexpected events like economic crisis or changing demands in major European projects such as Galileo. MEPs would therefore like to see a "global MFF margin" to be created, consisting of unused margins, decommitted and unused appropriations from the previous year. Members note that the 10-year MFF, as proposed by the Commission in the Budget Review, could provide substantial stability and predictability for the financial programming period but it may increase the rigidity of the MFF and render the adjustments to new situations extremely difficult. They consider, however, that a 5+5 cycle could only be envisaged if an agreement on a maximum level of flexibility, including an obligatory mid-term review, was reached with the Council and enshrined in the MFF regulation. Members take the view that for the next MFF a 7-year cycle, set until 2020, should be the preferred transitional solution as it could provide for more stability by ensuring the continuity of the programmes for a longer period, and also make a clear link with the Europe 2020 strategy.

Expected Polish Position

The drawing up of the EU budget will be on the agenda of the Polish Presidency; Poland will have to put aside its own interests in distribution of the EU money, as the country holding the Presidency should fulfil the impartiality requirement. Moreover, working on the Financial Perspective is a long and complex process which cannot be finalized during the time framework of only six months. The preparation of the Financial Perspective 2014–2020 will be on the agenda of the whole Poland-Denmark-Cyprus trio. For Poland, the goals of the starting period are defined as follows: to achieve the full understanding of the proposals, to gather all member states' positions towards them and to identify the issues that need to be negotiated. At the end of its Presidency Poland intends to present a report on the progress of the negotiations to the EU Council. At this stage Denmark will take over the further development of the Financial Perspective. The Presidency will not put Polish budgetary interests into the preferred position. Poland will have to promote its vital interests on the usual basis. Among the most important issues, Poland is concerned about the Cohesion and the Common Agricultural policies. The Czech Republic, similarly, has strong national interests in those areas, as both countries are net beneficiaries. Logically, the Cohesion policy and the CAP are possible fields of cooperation despite slight differences in the positions of both countries. The controversy between Czech and Polish positions in terms of further reform of CAP and Cohesion policy lies in different level of regional GDP (Polish NUTS2 regions are poorer than the Czech ones and thus can apply longer for finances from the EU budget); also the size and structure of the Polish agriculture sector will complicate the ability to find the common position to further reform of CAP.

Other Stakeholders

The long term debate is about the UK privilege to receive its rebate but also other countries which are traditionally net contributors negotiated for recent financial perspective special arrangements with the aim to keep their net positions limited. This group coordinated its policies even during negotiations on the recent financial perspective and we can expect it will repeat its argumentation

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again (Netherlands, Sweden, Germany). Once again, it will undoubtedly be a very sensitive topic as more actors are proposing termination of UK and other net contributor's countries advantages.

As mentioned above, the new member countries will try to support continuation of cohesion policy.

CAP itself will be a very sensitive topic, given the totally different view of the member states on its future role. Some member countries will require further reforms or even a transfer of CAP to the national level while other countries will require keeping it in the recent form.

The Eurozone crisis created another group of actors who will play an important role in the negotiations. On the one hand, there are countries using the financial help from funds created outside the EU budget; on the other hand, there are countries contributing to this stabilization mechanism. Voters in those countries are very afraid to create a transfer union of sorts (Germany) or are even unwilling to provide countries such as Greece with their own public funds (Slovakia). Some countries, such as the Czech Republic, are asking why to participate in such mechanisms, while considering their staying outside the Eurozone, without accepting requirements for providing their national funds to help problematic Eurozone countries.

Most member states including Czech Republic stress the controversy caused by the European Commission requirement of increasing the size of the EU budget, while strengthening the pressure on the member countries to control the size of national public expenditure via mechanisms such as European semester. From this point of view, most of the countries will oppose any significant increase in the size of EU budget.

Czech Official Position towards the EU Budget Reform and Negotiations of the Multiannual Financial Framework (MFF)

In the Czech Republic the most influential role will be played by the Ministry of Finance. In the past, their arguments served as the official position of the Czech Republic. Given the growing Euro-scepticism in the Czech Republic according to last public surveys, we cannot expect any relevant change in the recent position of the Czech government towards new financial perspective negations. Since 2008 the percentage of respondents sceptical to the introduction of Euro in the Czech Republic is growing. According to a survey which was ordered by European Commission in 2008, already more than 48% of the Czech respondents are against the introduction of Euro, with only 42% supporting the idea. The percentage of respondents against the introduction of Euro in the Czech Republic has even increased with the news about the dynamics of debt crisis in some Eurozone countries. The poll from April 2011[8] did show that already over 75% of respondents are against the introduction of Euro, with only 21% supporting the project. The Czech Republic is, therefore, likely to oppose any proposal to significantly increase the size of the EU budget with the aim to increase stabilization function of the budget for countries using Euro as a common currency. The following topics are essential for the Czech position:

Firstly, the period of validity should span over seven, not five years. From the Czech point of view, the longer period ensures certainty for beneficiaries and a stable environment for the implementation of multiannual programs.

As for the EU expenditures, the Czech Republic is in favour of a more extensive funding for education, research and mobility of students. From the Czech point of view, the current state of affairs in the cohesion policy with the focus on the less developed countries and regions should be preserved in the next Financial Perspective. Instead, the Czech Republic agrees on the comprehensive reform of the CAP and the gradual reduction of its total expenditures. At the same time, Czechs do not support an option of the CAP's co-financing from the national budgets. The Common Agricultural Policy should be preserved as an exclusively European policy.

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The Czech Republic will support the preservation of the same allocation criteria within the Social Fund as well as within the European Regional Development Fund. According to the Ministry of Finance of the Czech Republic,[9] the Czech Republic had a positive net condition towards the EU budget in every year of its EU membership. The total amount of net position during the period of 2004–2010 was 5 534,9 mil EUR. From this point of view, the requirement for phasing-out instruments is logic.

In regard to the revenue side, the Czech Republic opts for its simplification and increased transparency. This position is reflected in the claim for abandonment of the VAT resource and support for the traditional GNI-based resource. The Czech Republic is not supporting the idea of introducing new own resources in terms of the EU tax or any other new resources which will increase the tax burden.

Possible Correlations and Discrepancies between Czech and Polish Positions

Reform of the Expenditure Side of the EU Budget

Poland views the Cohesion and the Common Agricultural policies as extremely important. The Czech Republic, similarly, has strong national interests in those areas, as both countries are net beneficiaries. Logically, the Cohesion policy and the CAP are possible fields of cooperation despite slight differences in the positions of both countries. Moreover, the Cohesion Policy and CAP are issues that all the new EU member states can defend together. In this area the Czech Republic is very likely to support the position of Poland in Cohesion Policy; however, Czechs might find it difficult to find a common position regarding the future outlook of CAP. What is questionable is the position of old member countries towards a reform of Cohesion policy and CAP policy. UK is likely to link the discussion about its rebate to further reforms of CAP. As for Cohesion policy, the situation will be even more difficult. Some old member countries will propose further concentration of resources on the poorest regions; some will propose to use funds to help countries with debt problems, helping them increase their competitiveness and improve economic growth, harmed by their domestic fiscal situation.

Reform of the Revenues Side of the EU Budget

Only Belgium, Luxembourg and Poland explicitly support the introduction of a new EU resource, such as an EU tax, although a few more member states are open to the idea in principle. Bulgaria, the Czech Republic, Denmark, Germany, Ireland, Lithuania, Malta, the Netherlands, Slovakia and Sweden overtly oppose it.[10]

Opportunity for Cooperation between the Czech Republic and Polish Presidency – Recommendations

The member states holding the conservative stance towards the future of the EU budget, including the Czech Republic and Poland, are in a complicated position. The EU problem solving capacities are focused on the Eurozone and it is hard to draw the attention to poor regions of the EU. Therefore, enhanced cooperation among the EU-12 countries and utilization of all emerging opportunities is the only way leading to success.

- *Whereas Poland will be fulfilling the Council Presidency duties in the second half of the 2011, the Czech Visegrád Group presidency should focus on assessing the possibilities of the joint approach in the V4 or V4+ format in as many areas as possible.*

- *The Czech Republic should reassess its position to the Multiannual Financial Framework. Mainly the clause that sets the ceiling of the annual EU budget on 1% of the EU GNI should be redefined according to the latest development.*

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- *There should be a more intensive collaboration among EU-12 countries that all support robust Cohesion Policy, as the strong opposition against this important EU policy is visible in most of the EU-15 countries and most importantly among the net contributors to the EU budget.*

- *Common EU-12 strategy should include special provisions for NUTS 2 regions that will newly meet the objective 2 parameters, as this might bring southern European countries on the same board.*

Proposal for Polish presidency concerning new MFF

Given the size of the EU budget and the size of European stabilization mechanism, we can calculate what would be the new ceiling for the EU budget revenues in the financial perspectives starting in 2014. The estimated volume of financial instruments already used or reserved for help to indebted countries until June 2013 within ESMS and ESFS and after June 2013 within ESM is equal to 1.5% of EU GNI. If we include those instruments inside the EU budget with the aim of improving its stabilization function, the EU budget ceiling for revenues will rise up to 2.5% of EU GNI, in other words, it will increase accordingly the ceiling given by the decision of the EU Council for financial perspective 2007–2013 by 150%.[11]

There are several questions connected to the above proposal. The funds will be primarily used by the Eurozone member countries. Why should such countries as the Czech Republic, Poland or UK participate in such a mechanism, staying outside the Eurozone or having a permanent opt-out from membership in EMU? The arguments for decisions makers in those countries can be as follows: those countries already contribute to the system within the IMF framework and also within the EU budget guarantees for issued bonds. The second argument is even more tied to the European integration project. If the Eurozone project collapses, it can eventually also lead to the collapse of the whole integration project including the internal market with its free movement of goods, capital, people and services. And the internal market undoubtedly offers important benefits for all the member states, including those staying outside the Eurozone. The last argument which can support the proposal to increase the size of the EU budget is connected to the size of federal and national budgets. Even by increasing the EU budget by 150% up to 2.5% of EU GNI, it will be still significantly lower than comparable federal budgets and even marginal proportionally given the redistribution within national budgets.

The Eurozone debt crisis should thus be used as an opportunity to improve stabilization capacity of the EU budget according to fiscal federalism theory recommendations, moving the EU closer towards the last stage of the integration process, i.e. to a political union. The Polish presidency will not able to find solution to this qualitative change but it can use it as an opportunity to open discussion about the new MFF in innovative and very pro-integration dimension.

To conclude, it seems that "*we know what to do but we also know that there is no way we can achieve that*". It is a challenge not only for the Polish presidency but for the whole EU in the near future. Will the EU use it?

[1] 2011 budget, PA payment appropriations.

[2] Sapir, A. 'An Agenda for a Growing Europe. Making the EU Economic System Deliver', Report of an Independent High-Level Study Group established on the initiative of the President of the European Commission, July 2003, p. 162.

[3] MacDougall, D. Report of the Study Group on the Role of Public Finance in European Integration. Brussels, European Commission, 1977.

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[6] EC (2011). The added value of the EU budget. Staff Working Paper. SEC (2011) 867 final (29. 6. 2011). http://ec.europa.eu/budget/library/biblio/documents/fin_fwk1420/working_paper_added_value_EU_budget_SEC-867_en.pdf

[7] EC (2011). The added value of the EU budget. Staff Working Paper. SEC (2011) 867 final (29. 6. 2011). http://ec.europa.eu/budget/library/biblio/documents/fin_fwk1420/working_paper_added_value_EU_budget_SEC-867_en.pdf

[8] CVVM (2011). Občané o přijetí eura. http://www.cvvm.cas.cz/upl/zpravy/101149s_pm110516.pdf, accessed June 2011

[9] MF ČR (2011): Souhrnná čistá pozice ČR ve vztahu k rozpočtu EU: 2004 – 2010. http://www.mfcr.cz/cps/rde/xchg/mfcr/xsl/eu_cista_pozice_cr_49134.html

[10] DG Budget (2009). Contributions to Public Consultations on the EU Budget. http://ec.europa.eu/budget/reform/issues/read_en-.htm

[11] MacDougall, D. Report of the Study Group on the Role of Public Finance in European Integration. Brussels, European Commission, 1977.

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