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Hellenic and Southeastern European Studies**

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**Reforming the European Budget:  
An Ongoing Tale**

by

**Dimitrios V. Skiadas**



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**“The trouble with a budget is  
that it's hard to fill up one hole  
without digging another.”**

***Dan Bennett, American Comedian***

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## I. Introduction

It was the 17<sup>th</sup> of December 2005, when the meeting of the European Council, under the Presidency of the United Kingdom, ended, after long and arduous negotiations over the Multiannual Financial Framework for the period 2007-2013. At the time, all parties involved seemed very happy, each one for different reasons: The UK because it managed to conclude its term of Presidency with a successful deal over the budget; France because it maintained the status quo regarding the Common Agricultural Policy which is very favourable for French farmers; Germany because it was deemed as the major mediator for achieving the budget agreement, despite the fact that it still remained the biggest net contributor to the EU budget; the so called “cohesion-countries” (Spain, Portugal, Greece) because they maintained the bulk of the benefits they receive from the Union’s structural and cohesion fund within the framework of the Union’s regional policies; and the ten new Member States because they obtained a larger regional aid allocation than the one originally proposed.<sup>1</sup>

However, these positive reactions were the surface. The “*quid pro quo*” mentality that prevailed during the workings of the meeting demonstrated that the European Union has entered an era during which the course for European Integration has reached a dangerous curve. With the enlargement of the European Union by ten new Member States, new challenges have been identified across the entire spectre of the policies developed and implemented at Union level. The economic and social implications of the enlargement, due to the severe process of structural changes undertaken by the new Member States, have caused mounting concerns within the fifteen “old” Member States, especially with regard to income distribution, social policy, and impact on living standards.<sup>2</sup> In the light of these concerns, the most obvious field of testing the solidarity of the Union’s Member States was the occasion of setting the Multiannual Financial Perspectives for 2007-2013.

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<sup>1</sup> I. Begg, Fr. Heinemann, New Budget, Old Dilemmas, Centre for European Reform, Briefing Note, 22.2.2006, pp. 1-2.

<sup>2</sup> T. Boeri, H. Brücker, The Impact of Eastern Enlargement on Employment and Labour Markets in the EU Member States, European Integration Consortium (DIW, CEPR, FIEF, IAS, IGIER), 2000, pp. 1

This should not come as a surprise. Having and exercising authority over the European Budget has always been a focal point in the course of European Integration. A budget is defined as a procedure, according to which an administration forms its economic and financial policy, including its monetary aspects, and this policy is being accepted and implemented effectively.<sup>3</sup> It is not only a financial statement, or a method of financial assumptions and forecasts, or a system of controlling expenditure, or a decision making instrument, or a report aiming to the economic and financial development of a country, but all of the above.<sup>4</sup>

In the European Community context, a definition exists in Art. 4 para 1 of the Financial Regulation,<sup>5</sup> according to which the budget is the instrument which, for each financial year, forecasts and authorises all revenue and expenditure considered necessary for the European Community and the European Atomic Energy Community. This latter definition, setting the limits of the concept of the budget, is very helpful in identifying the importance of the budget in the institutional system of the European Union, as it will be analyzed further below. It suffices to note now that the European Budget is the instrument for the three classical functions of public finances: allocation, redistribution, and stabilisation. Allocating resources through the EU Budget is focussed mainly on agricultural and structural aid, in order to facilitate structural change in a period of rapid industrial change and to preserve food security. The redistribution function is mainly exercised through the operations of the Structural Funds, in order to support the regional policy and the economic and social cohesion of the Union. Finally, stability in EU public finance is a core element for the Economic and Monetary Union, which is supported indirectly through the EU budget, as this budget supports through its first two functions the national economies of the Member States, in the light of the provisions of the Stability and Growth Pact.

The historical course of the European Integration experiment teaches us that the budget negotiations over the Multiannual Financial Perspectives are inevitably becoming more complicated and complex. This is due not only to the increased heterogeneity of the European Union, because of the new Member States, in terms of

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<sup>3</sup> A.E. Buck, *Public Budgeting*, Harper and Brothers, 1929, p. 3.

<sup>4</sup> R. D. Lee, R. W. Johnson, *Public Budgeting Systems*, University Park Press, 1973, p. 2.

<sup>5</sup> Council Regulation 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities, OJ 2002 L248/8.

economic conditions, per capita income, policy preferences and cultural values and orientations, but also to fact that the variety of negotiated solutions between Member States on budgetary issues increases in accordance to the number of negotiators-Member States. It is interesting to elaborate a little further on this historical approach, because this will provide with a useful insight of the situation. After all, “a page of history is worth a volume of logic”.<sup>6</sup>

## II. Historical Development till 2000

In the 1980s, a series of events changed the Community’s image and created the conditions necessary for a radical and drastic change in the financial system of the European Communities, especially in the Structural Funds sector. The southward enlargement with the accession of Greece, Spain and Portugal and the adoption of the Single European Act had a major impact on the Community’s approach to the development of the common market.<sup>7</sup>

The Single European Act introduced an attempt to promote the Community’s social cohesion alongside its economic cohesion, by adding a relevant new title to the EC Treaty. The Community had to focus on strengthening its economic and social cohesion by reducing development disparities between its regions, through the coordination of the Member States’ economic policies and the Community’s financial support provided through the Structural Funds.<sup>8</sup> Thus the substantive framework for a major reform on the Community’s financial system, focusing on the Structural Funds, was created.

The reform that took place aimed a) at introducing additional resources into the financing of the budget, b) at increasing the weight of the structural financial assistance and limiting agricultural expenditure and c) at distributing at a fairer rate the burden of financing the budget on behalf of the Member States.<sup>9</sup> These aims were

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<sup>6</sup> This is one of the famous quotes by US Supreme Court Justice Oliver Wendell Holmes Jr, made in the case [New York Trust Co. v. Eisner](#), 256 U.S. 345, 349 (1921).

<sup>7</sup> European Commission, *Vade Mecum on the Reform of the European Community’s Structural Funds*, Brussels, 1989, p. 9.

<sup>8</sup> Art. 158-159 EC Treaty.

<sup>9</sup> T. Szemler, *EU Budget Milestones: From Fundamental Systemic Reforms to Organised Chaos*, EU-CONSENT Conference, Budapest 24.3.2006, pp. 2.

seen at three interrelated levels: political, financial and legal. Politically, the principle of solidarity among the Member States and the purpose of the common market required a reduction of the differences in the level of development between the various regions.<sup>10</sup> Financially, there was not only a need for assistance to the underdeveloped regions, but also a need to assure better financial management of the Community's resources which are a direct burden on European citizens.<sup>11</sup> Legally, the provisions introduced by the Single European Act provided for an amendment of the Structural Funds' operational rules.<sup>12</sup>

The introduction of additional resources took place through a complete amendment of the Community's system for its own resources. More specifically, according to the provisions of the Treaty, the revenue of the budget, based on the Community's own resources, will finance the operations included in the budget, covering the relevant expenditure. This has been the basis for characterising the budget of the European Union as a "Revenue Budget", in the sense that the revenue part of the budget is prepared first in order to be used as guidance for preparing the expenditure part of the budget.<sup>13</sup> Originally, from 1958 till 1970, the budget of the European Community was financed from contributions made by the Member States, according to a scaling system described in the original wording of the then Articles 200 and 201 of the EC Treaty. There was, however, a provision regarding the possibility of introducing a system of own resources, replacing the contributions. Such a system was established in 1970,<sup>14</sup> which was ratified by the Member States in accordance with their respective constitutional requirements.<sup>15</sup> This was deemed appropriate at the time, since the transition from a system of national contributions, controlled by the Member States, to an own resources system, controlled by the European institutions, was seen as a major change which included the transfer of economic national sovereignty on behalf of the Member States to the European institutions. The same ratification procedure was followed for all subsequent decisions of the Council with regard to the

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<sup>10</sup> European Commission, *Vade Mecum on the Reform...*, *op. cit.*, p. 11.

<sup>11</sup> *Ibid*, p. 11.

<sup>12</sup> *Ibid*, p. 11-12. For more details on the legal requirements see European Commission, *Reform of the Structural Funds: 1) Commission Communication, 2) Comprehensive Proposal pursuant to Art. 130d of the EEC Treaty*, COM (87) 376 final, OJ 1987, C 245/3.

<sup>13</sup> G. D. Drisis, *From the European Idea to the New Europe of Maastricht*, 1995, p. 135.

<sup>14</sup> Council Decision 70/243, OJ English Special Edition 1970(I) p. 224.

<sup>15</sup> P.J.G.Kapteyn, P. Verloren van Themmat, (edited by L. Gormley), *Introduction to the Law of the European Communities*, Kluwer Law International, 1998, p. 347.

own resources system. This original system of own resources included three types of resources: agricultural levies, customs duties and a percentage of national Value Added Tax applied to a uniform base. It is noteworthy that although it was anticipated that the Community budget would be financed entirely from own resources as from 1975, this did not happen until 1980.<sup>16</sup> During this period, the Member States paid transitional and declining contributions to balance the budget of the Community.<sup>17</sup> Also, there have been Member States which were – and still are – very sceptical about the system of own resources and this has led to a series of political negotiations on the mechanism of financing the Community budget.<sup>18</sup>

During the 1980s, it was found that the revenue resulting from the original own resources system was not enough to cover the expenditure of the Community, which was increased due to the introduction of new policies financed by the budget. Thus it was decided to reform the own resources system, at first by increasing the percentage of national Value Added Tax resource from 1% to 1,4%,<sup>19</sup> and then, when this was not deemed enough, by introducing a completely new system of own resources.<sup>20</sup> This new system set a ceiling for the total resources of the Communities, starting from 1,15% of the Community Gross Domestic Product in 1988 to 1.2% in 1992, while the commitment appropriations would not exceed 1.3% of the Community Gross Domestic Product in 1992. This aimed to ensure a stable stream of revenue to the budget.<sup>21</sup> Four types of own resources were set:

- a) agricultural levies on trade with non Member States and sugar and isoglucose duties, less 10% to be retained by the Member States as collection costs;

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<sup>16</sup> A.G. Toth, *The Oxford Encyclopaedia of European Community Law – Vol. I: Institutional Law*, Clarendon Press, 1990, p. 404.

<sup>17</sup> P.J.G.Kapteyn, P. Verloren van Themmat, (edited by L. Gormley), *op. cit.* p. 347.

<sup>18</sup> M.R. Emerson, T.W.K. Scott, *The Financial Mechanism in the Budget of the European Community: The hard core of the British “Renegotiations” of 1974-1975*, 14 *CMLR* (1977), 209-229.

<sup>19</sup> Council Decision 85/257/EEC, OJ 1985 L128/15.

<sup>20</sup> Council Decision 88/376/EEC on the system of the Communities’ own resources, OJ 1988 L 185/24. For more details on these reforms see A.G. Toth, *op.cit.* p. 404, P.J.G.Kapteyn, P. Verloren van Themmat, (edited by L. Gormley), *op. cit.*, p. 348.

<sup>21</sup> P.J.G.Kapteyn, P. Verloren van Themmat, (edited by L. Gormley), *op. cit.*, p. 354.

- b) Common Customs Tariff customs duties and customs duties on products covered by the European Coal and Steel Community, less 10% to be retained by the Member States as collection costs;
- c) the application of a uniform rate of 1.4% to the Value Added Tax assessment base which is determined in a uniform manner for Member States according to Community rules, but the assessment base may not exceed 55% of the Gross National Product at market prices for each state;
- d) the application of a rate - to be determined during the budgetary process each year in the light of the total of all other revenue – to each Member State’s Gross National Product at market prices.

The fourth resource was a novelty and its aim was – and still is – to balance the Community budget and to match each Member State’s payments to the budget more closely to its ability to pay, therefore it is called an “additional resource”.<sup>22</sup>

Increasing structural financial assistance over agricultural expenditure was deemed imperative for three reasons.<sup>23</sup> First, there was a general and increasing doubt that the Structural Funds’ resources were being used as effectively as possible. Second, the enlargement of the Community (with the accession of Greece, Spain and Portugal) increased the extent and diversity of structural problems facing the Community. Third, the Funds had to be capable of functioning effectively because the underlying policies were essential to the successful achievement of the large market.

The core of the reform consisted of five principles:<sup>24</sup>

- the establishment of five priority Objectives for the Funds’ activities;
- the establishment of the principle of Partnership between the Commission and the national authorities regarding the planning and implementation of structural measures;
- the integration of Community Structural action with national economic policies;
- better financial management of the Structural Funds;
- the simplification, monitoring, flexibility of Community Structural action.

<sup>22</sup> P.J.G.Kapteyn, P. Verloren van Themmat, (edited by L. Gormley), *op. cit.*, p. 355.

<sup>23</sup> Ph. Lowe, The Reform of the Community’s Structural Funds, 25 *CMLR*, (1988), p. 503-521 at 509.

<sup>24</sup> European Commission, *Vade Mecum...*, *op. cit.*, p.13.

It was reasonable to expect that such radical changes would affect the overall financial system of the Community, and especially the behaviour of its key players, the institutions. The historical experience of the budgetary procedure (see below) has demonstrated that there are certain threats to the budgetary discipline of the European Community. The European Parliament's tendency to increase the non compulsory expenditure, the continuous increase of agricultural guarantee expenditure by the Council, and the various forms of competition between the Parliament and the Council which resulted even in judicial conflicts, are some of these threats.<sup>25</sup>

In order to strengthen the efforts for achieving budgetary discipline, it was decided to enact legislative instruments in that direction. Council Decision 88/377/EEC on budgetary discipline<sup>26</sup> and the 1988 Interinstitutional Agreement on budgetary discipline and improvement of the budgetary procedure<sup>27</sup> were the main options. The main idea was that the Council, the Commission and the Parliament have a shared responsibility for budgetary discipline, without affecting their competences, as these are described in the EC Treaty, and they need to develop a pragmatic cooperation in that respect.<sup>28</sup> In terms of substance, the budgetary discipline is maintained by setting financial perspectives, i.e. by preparing a harmonious and controlled development in the broad sectors of expenditure and by establishing a balance in the allocation of expenditure, especially between the expenses on agriculture and those on social and economic cohesion. The financial perspectives are regarded as binding expenditure ceilings for committing appropriations and for making payments.<sup>29</sup>

In the early 1990s, the development of the international financial situation, as well as the progress towards European Integration, necessitated another reform of the Community's financial system. The new Common Agricultural Policy, agreed on

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<sup>25</sup> P.J.G.Kapteyn, P. Verloren van Themmat, (edited by L. Gormley), *op. cit.*, p. 355.

<sup>26</sup> OJ 1988 L 185/29.

<sup>27</sup> OJ 1988 L 185/33.

<sup>28</sup> P.J.G.Kapteyn, P. Verloren van Themmat, (edited by L. Gormley), *op. cit.*, p. 356.

<sup>29</sup> P.J.G.Kapteyn, P. Verloren van Themmat, (edited by L. Gormley), *op. cit.*, p. 356.

1992, the evaluation of the Structural Funds operations, the establishment of the Single European Market and the perspectives of the Economic and Monetary Union, set by the Maastricht Treaty, were factors that led to the re-examination of the system.<sup>30</sup>

This exercise led to a new reform, somewhat of a smaller scale, compared to the first. The basic principles remained the same. However, given the expanding policies of the Union and the increase of the corresponding expenditure, the own resources system was amended and the overall ceiling of the resources was set to 1,27% in 1999 and the VAT assessment base was set to decline from 1.2% to 1% in 1999.<sup>31</sup> This implied that the importance of the VAT resource decreased and the fourth or additional resource was considered more useful, as it allowed the financial burden to be allocated more according to the ability of each Member State to pay.<sup>32</sup>

Furthermore, given the financial constraints imposed in order to achieve the Economic and Monetary Union, it was decided to introduce a provision in the EC Treaty that would provide for the discipline that would be necessary for the finances of the European Union. Therefore, the Maastricht Treaty (Treaty on the European Union) introduced Art. 270 EC Treaty (then numbered Art. 201a), in order to ensure that any action relating to the initiation of Community legislation has been preceded by an estimation of the financial limitations within which the European Union must operate.<sup>33</sup> This also necessitated the amendment of the financial perspectives, with the introduction of new instruments, setting new financial perspectives for the period 1993-1999 and introduced new conciliation procedures between the three institutions involved.<sup>34</sup>

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<sup>30</sup> T. Szemler, *op. cit.*, p. 4.

<sup>31</sup> Council Decision 94/728/EC, OJ 1994, L 293/9 (corrigenda OJ 1994, L 299/32 and L 303/62).

<sup>32</sup> P.J.G.Kapteyn, P. Verloren van Themmat, (edited by L. Gormley), *op. cit.*, p. 362.

<sup>33</sup> W. Cairns, *Introduction to European Union Law*, Cavendish Publishing Ltd, 1998, p. 56.

<sup>34</sup> Council Decision 94/729/EC, OJ 1994, L 293/14, 1988 Interinstitutional Agreement on budgetary discipline, OJ 1993, C 331/1.

As for the Structural Funds, the 1993 reform was based on the Protocol on Economic and Social Cohesion (Protocol No 15) annexed to the EU Treaty. According to this document, the Member States wanted greater flexibility in the arrangements for allocations from the Structural Funds in order to meet specific needs not covered by the structural Objectives. They also approved the modulation of the Community's participation in the context of Structural Funds' programmes and projects, with a view to avoiding excessive increases in budgetary expenditure in the less prosperous Member States. It has been said, however, that this Protocol is not covered by Art. 311 [ex 239] EC Treaty, which states that the protocols to the EC Treaty form an integral part thereof but does not refer to protocols annexed to the EU Treaty.<sup>35</sup> Therefore Protocol No 15 of the EU Treaty is merely an important political declaration, having no supplementing, amending or modifying effects on the EU Treaty.<sup>36</sup> The five principles of the 1988 reform were maintained, and attention was paid mainly to management procedures of the structural operations, focusing mainly on procedural issues rather than substantive ones. The revised provisions aimed a) to achieve more transparency by involving the social partners more closely in the operations, thereby improving the partnership principle, and by using additionality to evaluate the effectiveness of the structural operations, b) to establish simpler and more flexible procedures and c) to allow for more rigorous financial control in light of the additional resources involved.<sup>37</sup> Also, a preference for subsidiarity was noted, by making national and regional authorities more active in administering the operations financed by the Structural Funds and sometimes in allocating the relevant resources.<sup>38</sup>

These two reforms were an ambitious attempt to make the Structural interventions of the Community more effective. The European Court of Auditors has pointed out that they enabled the Commission to secure more appropriations and support more structural measures with the same human resources.<sup>39</sup> It has been noted that the two

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<sup>35</sup> T. Frazer, *The New Structural Funds, State Aids and Interventions on the Single Market*, (1995) 20 E.L.Rev., p. 3-19 at 14-15.

<sup>36</sup> T. Frazer, *op. cit.*, p. 15.

<sup>37</sup> J. Kenner, *Economic and Social Cohesion-The rocky road ahead*, LIEI (1994/1), p. 1-37 at 26, T. Frazer, *op. cit.*, p. 5.

<sup>38</sup> T. Frazer, *op. cit.*, p. 5.

<sup>39</sup> European Court of Auditors, *Sound Financial Management in the European Union Budget*, Luxembourg 1997, p. 43, European Court of Auditors, *Annual Report for the Financial Year 1990*, OJ 1991, C 324/1 at 98-105.

reforms have been successful as the second supplemented the first in order to make the Union capable of facing the challenges of the 1990s.<sup>40</sup> But the biggest challenge was still to come...

### III. Agenda 2000: The end of the beginning or the beginning of the end?

It was thought that after two successful reforms the 1980s and 1990s, it would be easy for the European Union to enter the 21<sup>st</sup> century with a new, more effective financial system, capable of meeting the requirements of the Eastern Enlargement as well as of the full operation of the Economic and Monetary Union.

However, the various incidents in the late 1990s, within the European Commission, regarding the management of the budget,<sup>41</sup> created serious doubts about the ability of the European Institutions to set and implement a budgetary system that would meet the needs of the Union, especially in view of the challenges ahead. Therefore two major political initiatives were undertaken in order to remedy the political and substantive damage to the Union's budgetary system and at the same time provide the Union with a new Financial Perspective. The first was called "The Sound and Efficient Management 2000 Initiative", which will be analysed further below. The second was called "Agenda 2000".<sup>42</sup>

This initiative contained proposals for the reform of the European Union's policies. Two factors called for reform. The first was the enlargement of the European Union to the East and the second was the consolidation of developments within the Union, namely the realization of Economic and Monetary Union and the new provisions of the Treaty of Amsterdam. In Agenda 2000, the Commission outlined new objectives for the Union's policies, including: increasing competitiveness of European enterprises, the modernization of employment systems, a high quality of life, a cohesive society based on solidarity, a sound environment, freedom, security and justice. It is obvious from these objectives that economic and social cohesion remain a

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<sup>40</sup> T. Szemler, *op. cit.*, p. 4.

<sup>41</sup> For these incidents, see D. Skiadas, *The European Court of Auditors*, European Dossier Series, Kogan Page Publishers, 2000, pp. 64-74.

<sup>42</sup> European Commission, *Agenda 2000: For a Stronger and Wider Union*, Doc 97/6, Strasbourg, 15 July 1997.

political priority. The Commission identified the need to address the unequal abilities of the regions of the Union to generate sustainable development and their difficulties in adapting to new labour market conditions, which require a more forward-looking adaptation of the skills of working men and women. In the Commission's opinion, the Structural Funds should aim to foster competitive development and sustainable and job-creating growth throughout the Union and the promotion of a skilled, trained and adaptable workforce.

There were four major issues to be dealt with, within this framework:<sup>43</sup>

- Decisions had to be taken at the same time on the mid-term financial perspective and on the reform of the Common Agricultural Policy and of the structural operations;
- Due to the stability requirements of the Economic and Monetary Union (the Maastricht criteria), there was no readiness for increasing the ceiling of own resources;
- The problem of unbalanced positions vis-à-vis the EU budget has become more important (concerned more Member States) than before;
- The budget had to provide adequate resources for the eastward enlargement of the EU; to make this task even more complicated, the time and the magnitude of enlargement was unknown.

The situation was thus considerably more difficult than in 1992, and this led to much tougher discussions between Member States. The European Parliament examined the Commission's proposals carefully and expressed its views in a series of reports and resolutions.<sup>44</sup> It took almost two years from the publication of the Agenda 2000, to reach an agreement, during the meeting of the European Council in Berlin on 24–25 March 1999, the conclusions of which reflected the various compromises.<sup>45</sup> A new Financial Perspective was established, covering the period 2000-2006.

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<sup>43</sup> T. Szemler, *op. cit.*, p. 6.

<sup>44</sup> See European Parliament, Doc A4-0380/98-Kellett-Bowman, Doc A4-0391/98-McCarthy, Hatzidakis, Doc A4-0393/98-Varela Suanzes-Carpegna, Doc A4-0395/98-Collins, Doc A4-0398/98-Jöns.

<sup>45</sup> European Council, Presidency Conclusions, Berlin 24-25 March 1999, Doc 100/99.

According to the Financial Perspective, the own resources system maintained the four main types of resources.<sup>46</sup> However the rate of call of the VAT resource was set to decline to 0,75% for the years 2002 and 2003 and to 50% from 2004 onwards. Also the relevant assessment base to be taken into account would not exceed 50% (instead of 55% before) of the Gross National Product for each Member State. It is obvious that the importance of the VAT resource continued to decrease. Finally, the overall ceiling of the amount of own resources was calculated according to a formula, using as basis the 1,27% ceiling of the previous Council Decision. The same applies for the maximum rate of the appropriations for commitments, and the basis used was a figure representing the 1,335% of the total Gross National Product of the Member States.

As for the allocation of the resources, 298 billion euros were given to the Common Agricultural Policy, while 208 billion were given to structural and cohesion policies. A new reform of the Structural Funds was proposed<sup>47</sup> and resulted in a series of new Regulations, setting the Funds' main areas of assistance: infrastructure, development of human resources, and support for the productive sector.<sup>48</sup>

The reform has been criticised for the limited justification of the geographical concentration of structural assistance: since relative disadvantage is widely spread throughout the European Union, there is no obvious reason not to spread the structural resources appropriately.<sup>49</sup> It has also been pointed out that while under the 1988 and 1993 Regulations the territories eligible for assistance under Objective 1 were determined by the Council and the relevant list was included as an annex to the Regulations regarding the Structural Funds, the 1999 Regulations grant the Commission the task of selecting the eligible regions. The Member States are therefore excluded from the selection process, which appears mechanical but is of vital importance since it determines the recipients of structural assistance.<sup>50</sup> This exclusion of the Member States has been combined with expressions used to the 1999

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<sup>46</sup> Council Decision 2000/597/EC, OJ 2000, L 253/42.

<sup>47</sup> European Commission, Reform of the Structural Funds, COM(1998)131 final.

<sup>48</sup> Regulation 99/1260/EC OJ 1999, L 161/1, Regulation 99/1783/EC OJ 1999, L 213/1, Regulation 99/1784/EC OJ 1999, L 213/5, Regulation 99/1263/EC OJ 1999, L 161/54, Regulation 99/1257/EC OJ 1999, L 160/80, Regulation 99/1264/EC OJ 1999, L 161/57.

<sup>49</sup> J. Hough, *The Reform of the European Structural Funds and the Cohesion Funds*, Research Paper 98/92, November 1998, Economic Policy and Statistics Section, House of Commons Library, p. 21.

<sup>50</sup> J. Scott, *Regional Policy: An Evolutionary Perspective*, in P. Graig, G. De Búrca, *The Evolution of EU Law*, Oxford University Press, 1999, p. 625-652 at 630.

Regulations referring to the partnership principle,<sup>51</sup> which made it so flexible that it could undermine the obligatory nature of the concept of partnership.<sup>52</sup> Given the above mentioned scepticism of the Member States towards the Commission's ability to manage the resources of the Structural Funds, and their will to be able to set the financing priorities themselves, this has been a point of political conflict between the Commission and the Member States.

Furthermore, Agenda 2000 aimed at consolidating budgetary discipline at EU level. Based on the conclusions of the European Council meeting in Berlin on 24 and 25 March 1999, the European Institutions reached the 1999 Interinstitutional Agreement on budgetary discipline and improvement of the budgetary procedure.<sup>53</sup> The principal concept was that the European Union's expenditure must respect both the imperative of budgetary discipline and efficient expenditure. In order for that to be achieved, the budget must be regarded as the basis for the collection of the revenue or the payment of expenditure. Only when the relevant budgetary lines include authorisation of revenue or expenditure, the relevant transactions may take place. And such transactions may not exceed the limits set by the budget. Finally it is in accordance to budgetary discipline for all appropriations entered in the budget to be justified and their necessity must be analysed.

It must be noted that, by that time, the use of Interinstitutional Agreements, not only in the area of the budgetary discipline and procedure but also in other areas of European Union Law, had become very common, as these Agreements had been acknowledged as very important legislative instruments, which even though they did not supplement the provisions of the Treaty, they could be used for their

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<sup>51</sup> This principle exists in all structural operations financed by the Union. Its original definition exists in Regulation 88/2052/EEC which defined partnership in Art. 4(1) as "Close consultations between the Commission, the Member State concerned and the competent authorities designated by the latter at national, regional, local, or other level, with each party acting as a partner in pursuit of a common goal. The partnership shall cover the preparation, financing, monitoring and assessment of operations."

<sup>52</sup> J. Scott, *op. cit.*, p. 640.

<sup>53</sup> OJ 1999, C 172/1. In addition to this Agreement, Council Regulation 2000/2040/EC on budgetary discipline (OJ 2000, L 244/27) was introduced, providing that budgetary discipline shall apply to all EU expenditure. It focuses on the expenditure caused by the agriculture guarantee operations of the European Agricultural Guidance and Guarantee Fund, as well as on the establishment of budgetary reserves, which will serve to cover expenditure occurred in external actions (ie actions outside EU territory) in the sectors of agriculture or the provision of emergency aid in non-Member States of the European Union.

implementation.<sup>54</sup> The Interinstitutional Agreements are considered to be sui generis acts, having a legal status somewhere in between a political undertaking and a legal obligation and they are often described by the term “soft law”, something that is especially the case for the Agreements on budgetary discipline.<sup>55</sup>

In order for the budget to operate as the principal instrument for budgetary discipline, it must be regarded as the main legislative text authorising the entire expenditure of the European Union. Consequently, the budget should be an overall expression of the policies promoted by the Union. It has been argued that this is a mistaken approach because the budget is merely supporting the Union’s policies, being formed after these policies have been established.<sup>56</sup> Such an argument is correct in so far as it states that the budget does not precede the decision of establishing a policy. It is true that the budget is the necessary legal basis for all expenditure, but it cannot be a legal basis for expenses that go beyond the context of the provisions of the Treaties.<sup>57</sup> However this has not been always the case, since there are examples of policies such as humanitarian aid to victims of disasters or pilot projects, whose existence is based solely on being included in the budget and not on previous political decisions by the Council.<sup>58</sup> Consequently, since all the Union’s policies are financed through the budget, it is only logical to assume that the budget is an overall expression of these policies.

The real problem lies with the manner of expressing these policies in the budget. Usually they are expressed in rather vague terms. The result of this situation is that the less precisely the policy objectives are defined, the more difficult it is to evaluate their merits and to assess whether value for money is achieved in the pursuit of those objectives.<sup>59</sup> There are two reasons for this vagueness in defining policy objectives. One is that those with political responsibility for policy matters do not accept any

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<sup>54</sup> Opinion of Advocate General La Pergola in Case C-41/95, *Council of the European Union v. European Parliament*, [1992] ECR I-4411 at 4427.

<sup>55</sup> Mönar, Interinstitutional Agreements: The Phenomenon and its new dynamics after Maastricht, 31 *CMLR* (1994) 693-719.

<sup>56</sup> L. Kolte, The Community Budget: New Principles for Finance, Expenditure Planning and Budget Discipline, 25 *CMLR* (1988) 488.

<sup>57</sup> P.J.G.Kapteyn, P. Verloren van Themmat, (edited by L. Gormley), *op. cit.*, pp. 370-371.

<sup>58</sup> P.J.G.Kapteyn, P. Verloren van Themmat, (edited by L. Gormley), *op. cit.*, pp. 371-372.

<sup>59</sup> I. Harden, F. White, K. Donnelly, The Court of Auditors and Financial Control and Accountability in the European Community, 1 *EurPL*, (1995) 615.

criticism for their actions.<sup>60</sup> The other is more complex since it concerns the so called “abuse of budgetary powers”. Sometimes, the vague terms used in order to describe a Community policy aim to include in the budget the financing of activities that are doubtfully within the Communities’ own competence. There are procedural, political and legal causes for this.<sup>61</sup>

The procedural cause concerns the distinction between compulsory and non-compulsory expenditure. In their competitive attempt to become more influential than each other, both the Council and Parliament tend to include in the budget several items of expenditure as compulsory or non compulsory, according to their aims but sometimes exceeding the limits of Community competence. The political cause is that within the Council, several Member States find it difficult to oppose certain political choices that are perhaps beyond the Communities’ or the Union’s competence, but have a laudable context. The legal cause concerns the doctrine of “actions ponctuelles”, according to which expenditure on such actions does not require legislative authorisation because “it falls within the scope of the inherent powers which are incidental to the Commission’s executive role”.<sup>62</sup> More specifically the “actions ponctuelles” doctrine is based on the distinction between budget lines which authorise expenditure for measures forming part of a Community Policy but which cannot be precisely described and specified in the budget, and appropriations destined for clearly defined and specific measures. In the case of the former, another legal basis besides inclusion in the budget is necessary while in the latter case inclusion in the budget is sufficient.<sup>63</sup>

This doctrine is also reflected in the reasoning of the European Court of Justice, which declared that the conditions under which the legislative powers (ie formalising a policy) and the budgetary powers (ie financing a policy) are exercised are not the same, therefore care must be taken in exercising them as they can influence each other.<sup>64</sup> Since there is no provision in the EC Treaty giving precedence to the legislative powers over the budgetary powers or vice versa, it is not allowed to

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<sup>60</sup> I. Harden, F. White, K. Donnelly, *op. cit.*, 615.

<sup>61</sup> A. Dashwood, The limits of European Community powers, 21 *ELRev*, (1996) 126.

<sup>62</sup> A. Dashwood, *op. cit.*, p. 127.

<sup>63</sup> P.J.G.Kapteyn, P. Verloren van Themmat, (edited by L. Gormley), *op. cit.*, p. 372.

<sup>64</sup> Case 242/87, *Commission of the European Communities v. Council of the European Communities*, [1989] ECR 1425 at 1454.

formulate policies with normative provisions within the budget (this refers especially to the European Parliament), nor to develop normative provisions in financial terms in such a way that any discretion within the budgetary procedure practically disappears (this refers especially to the Council).<sup>65</sup>

The above shortcomings of the Union's budgetary system, as revealed by the attempt to implement Agenda 2000, may be one of main causes for the Union's inability to perform in a manner that would make the peoples of the Union's Member States more friendly towards the new steps of European Integration, i.e, the Constitutional Treaty and the Reform Treaty of Lisbon. Sustaining the European Union's capacity to act therefore requires not only new financial engineering, but also a fundamental rethink of the European Union's economic governance and of the financial means and resources necessary for achieving its objectives. Therefore, before examining the most recent procedure on establishing the Financial Perspectives for the period 2007-2013 and making some comments on the process of reforming the European Budget, which is currently in progress, it is useful to examine the status quo of the regulatory framework on this issue.

#### IV. The *Acqui Communautaire* regarding the European Budget: The Budgetary Rules

**The provisions regarding the European budget are included in articles 268 to 280 of the EC Treaty. The blocked European Constitution included them under Title VIII. These provisions establish certain basic rules that must be respected when drafting and implementing the budget. These rules are known as budgetary rules. Such rules exist in every budget. Their existence has been monitored and analysed since 1935 and until now it has been found that their basic concepts have remained the same.**<sup>66</sup>

**In general these rules are the following: The rule of Unity according to which all financial activity will be included in one single document known as the budget; the rule of Universality according to which the budgetary revenue may not be allocated to particular items of expenditure and no adjustments between revenue and expenditure may take place; the rule of Annuality according to which the budget covers a single and complete financial year; the rule of Specification according to which the appropriations made available are not aggregated but allocated to the various budgetary headings and subheadings and the rule of**

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<sup>65</sup> P.J.G.Kapteyn, P. Verloren van Themmat, (edited by L. Gormley), *op. cit.*, p. 371.

<sup>66</sup> J. Burkhead, *Government Budgeting*, John Wiley and Sons, 1956, p. 106-107.

**Equilibrium between expenditure and revenue according to which the revenue and expenditure shown in the budget shall be in balance.<sup>67</sup>**

**Besides these rules, the Financial Regulation provides for some additional budgetary rules (therein called principles) which are applicable to the budget of the European Community and they correspond to its needs. They are the principle of Budget Accuracy according to which all items of revenue and expenditure included in the budget must have a specific content, the principle of Unit of Account, the principle of Sound Financial Management and the principle of Transparency.**

**These principles have been very instrumental in the development of the Union's budgetary system. The regular management of the Union's resources, on a day-to-day basis, has been conducted in accordance to these principles, and practical solutions have been adopted in order to tackle several problems.**

For instance, while the rule/principle of Annuality means practically that any appropriation not used within the financial year for which they have been will be cancelled, it is possible to transfer unexpended appropriations (except those relating to staff expenditure) to the following financial year under the conditions described in detail in Art. 9 of the Financial Regulation. It is indicative of the exceptional nature of this transfer the fact that these appropriations may be used by the institution that made such a transfer, only after the appropriations authorised for the current financial year have been exhausted.

The rule/principle of Specification aims to ensure that the appropriations available through the budget are not aggregated but allocated to specific destinations.<sup>68</sup>

However there are exceptions from this rule, as described in Articles 22-26 of the Financial Regulation. As stated in these provisions, the maximum amount that may be transferred from one title or chapter or line to another, by each institution, may not exceed 10% of the appropriations allocated to it for the specific financial year. Such a

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<sup>67</sup> For a detailed analysis of the budgetary rules see D. Strasser, *The Finances of Europe* (1991) p. 41-72 & G. D. Drisis, *From the European Idea to the New Europe of Maastricht* (1995) pp. 119-121 and 148-151. It must be noted that the rule of Equilibrium is known as the "golden rule" in public finance, as it allows for the development and implementation of a sound economic and financial policy, without deficits.

<sup>68</sup> A.G. Toth, *op. cit.*, p. 85.

transfer must be notified to the budgetary authority three weeks in advance and the competent body (the Council for compulsory expenditure and the European Parliament for non compulsory expenditure – see below for more details) will decide on the transfer.

Extreme importance is attributed to the principle of Sound Financial Management. This principle is regarded as an additional basic budgetary rule of the Community.<sup>69</sup> Adhering this rule has become perhaps the most significant obligation of the European Commission as well as the Member States cooperating with the Commission, with regard to the implementation of the budget. So far, three types of management of the Community resources included in the budget have been identified. The first is the direct management meaning that the Commission – or any other institution as appropriate - manages the appropriations directly and completely. A classic example is the administrative appropriations included in the budget. The second is the decentralised management meaning that the Commission works through national government departments. An example of this type of management is the collection of revenue based on the own resources system. The third is the shared management meaning that the Commission works alongside national government departments on a complementary basis with regard to policies jointly financed. This is the case for the management of appropriations allocated, through the budget, to the Structural Funds.<sup>70</sup>

In order for all these types of financial management to be considered as sound, it must be established that they meet three conditions representing three inter-related aspects of management: Economy, Efficiency and Effectiveness (commonly known as the three “Es”).<sup>71</sup> The “Economy” aspect relates planned input of resources to the actual input, determining whether the least expensive means of achieving a given target have been used or not (examination of alternatives). The “Efficiency” aspect concerns

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<sup>69</sup> D. Strasser, *op. cit.*, p. 69-70.

<sup>70</sup> D. Strasser, *op. cit.*, p. 218-219.

<sup>71</sup> T. James, The Court of Auditors of the European Communities and the external audit bodies of the Member States in *Honorary Volume for the 150 years of the Greek Court of Audit* (1984) 475, D. Strasser, *op. cit.*, p. 279. See also Art. 27 para 2 of the Financial Regulation.

the relationship between actual input (resources) and actual output (results achieved), determining whether the means adopted were employed in the most appropriate manner (examination of performance). “Effectiveness” is measured by comparing actual output with planned output, determining whether the purpose has been achieved or not (success rate).

During the last years, several actions have been undertaken in order to improve the management capacity of the European Institutions. The Sound and Efficient Management 2000 Initiative, introduced by the Commission, provided for concrete measures to be adopted. These included, inter alia, the establishment of a closer link between political and budget priorities, the evaluation of functions in spending departments, the consolidation of audit and control mechanisms, the reduction of possible conflicts of interest, etc.<sup>72</sup>

Several other documents had been prepared identifying the following areas, where it was deemed necessary to take action in order to ensure sound financial management:<sup>73</sup>

- Radical reform of the way in which political priorities are set and resources are allocated. Through decision making mechanisms and appropriate timetables, this will ensure that activities undertaken by the Commission are supported by the necessary human, administrative and financial resources (activity based management and activity based budgeting). The thorough evaluation of action taken will be made part of daily management activities.
- Important changes to human resources policy, placing a premium on continuous training, quality of management, and improving recruitment and career development. These changes will also place an emphasis on improving the working environment and equal opportunities, as well as the evaluation of

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<sup>72</sup> K. Ebermann, *The SEM 2000 Initiative – Improving the Management of Community Expenditure* in R. Levy (ed), *Managing, Monitoring and Evaluating the EU Budget: Internal and External Perspectives* (1999), 52.

<sup>73</sup> European Commission, *Consultative Document on Reforming the Commission*, CG3(2000) 1/17, European Commission, *Commission Reform-Strategic Options Paper*, CG3(1999) 10/6, European Commission, *Reforming the Commission-Action Plan*, CG3(2000) 1/18.

individuals and will enable disciplinary matters or cases of under-performance to be dealt with properly and reasonably.

- Far-reaching reforms of financial management, enabling each department to establish its own, internal audit system appropriate to its own needs. In doing so, departments will be able to draw on the advice of the Commission's specialist services. Reform is predicated upon a precise definition of the responsibilities of each actor and upon regular checks by the Internal Audit Service – a new service within the Commission - of the quality and reliability of each audit system.

The Commission's approach is reflected in a White Paper, published in March 2000.<sup>74</sup> With regard to the system of financial management, control and audit, three main reforms have been identified as necessary:<sup>75</sup>

- A radical overhaul of the system, including the creation of new organisational structures and the replacement of others, in order to make the best use of resources and expertise and take into account the different types of expenditure that for which Commission is responsible.
- The definition of the responsibilities of authorising officers and line managers for the quality, correctness and efficiency of their actions.
- The adoption of measures to protect the Community's financial interests by improving the relevant legislation and the cooperation between the Commission and the competent authorities of the Member States.

In order to create a real sense of responsibility and accountability of authorising officers and Line Managers for sound financial management the Commission adopted several measures.<sup>76</sup> First, it defined clearly the responsibilities of each financial actor (authorising officer, accounting officer, financial controller) by enacting a set of clear relevant rules which will be given to the persons concerned. Appropriate training is also provided. If the actors concerned fail to meet the Commission's standards, their

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<sup>74</sup> European Commission, *Reforming the Commission-A White Paper*, COM(2000)200 final. This document was divided into two parts, the first containing the analysis of the proposals and the second containing the relevant action plan including the timetable for the reform's implementation.

<sup>75</sup> European Commission, *Reforming the Commission-A White Paper, Part I*, COM(2000)200 final, p. 20.

<sup>76</sup> European Commission, *Reforming the Commission-A White Paper, Part I*, COM(2000)200 final, pp. 20-21, and European Commission, *Reforming the Commission-A White Paper, Part II-Action Plan*, COM(2000)200 final, pp. 53-54.

responsibilities are withdrawn. Secondly, the Commission confers power to authorise expenditure to Community officials on the principle that the person taking the decision to proceed with an operation involving expenditure should also be the one authorising the expenditure. Only in exceptional cases the College of Commissioners retains its power to authorise expenditure. These cases are regulated by the Commission's internal rules on the execution of the budget. Thirdly, in cases of financial errors or irregularities not involving fraud, the Director-General of the department concerned may, before initiating disciplinary proceedings, refer the case to an advisory panel, the Financial Irregularities Panel. This considers whether there are systemic shortcomings and, if so, which is the responsibility of the persons involved in managing the control system. It is intended to be an intermediary step between the detection of an irregularity and the possible start of formal disciplinary proceedings. These measures are reflected throughout the Financial Regulation.

In order to overhaul the system of Financial Management, Control and Audit, the Commission introduced measures to decentralise and simplify its procedures in order to facilitate the efficient implementation of the budget.<sup>77</sup> The most noteworthy measure is the separation of the internal audit operation from the *ex ante* internal financial control and the creation of an Internal Audit Service as suggested by the Committee of Independent Experts<sup>78</sup> and the Commission itself.<sup>79</sup> The rationale for this measure is that since the internal audit will include an evaluation of the internal control system, this will lead to a conflict of interests as the officials performing the audit will be obliged to evaluate controlling operations which they have conducted themselves. Thus, their audit will be probably biased and any defects in the internal control will not be reported. Consequently the internal audit must not be performed by the same body which performs the internal *ex ante* financial control. Thus the internal audit operation is performed by a new body, an Internal Audit Service, operating under the provisions of Articles 85-87 of the Financial Regulation, the contents of

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<sup>77</sup> European Commission, *Reforming the Commission-A White Paper, Part I*, COM(2000)200 final, pp. 21-23 and European Commission, *Reforming the Commission-A White Paper, Part II-Action Plan*, COM(2000)200 final, pp. 55-66.

<sup>78</sup> Committee of Independent Experts, *First Report on Allegations regarding Fraud, Mismanagement and Nepotism in the European Commission*, 1999, pp. 143.

<sup>79</sup> European Commission, *Proposal for a Council Regulation amending the Financial Regulation and separating the internal audit function for the ex ante financial control function*, COM(2000) 341 final.

which were based on the recommendation of the Committee of Independent Experts.<sup>80</sup> Other measures include the actual decentralization of the control operations within the Commission. The Directorate General for Financial Control was abolished. Its tasks were distributed as follows: the *ex ante* control and verification of operations is performed by the authorizing officers within the operational Directorates, the internal audit is performed by the Internal Audit Service, the training and coordination of the relevant officials (especially in the Member States) is undertaken by the Central Financial Service and the *ex post* verifications and system audits in the Member States is performed by the operational Directorates. Based on common minimum standards defined by the Central Financial Service, the Directorates-General review their internal control systems and prepare a report to be sent to the Central Financial Service which oversees the implementation of the standards. Within the Directorates General there are financial units producing the Annual Activity Report of the Directorates and ensuring that the accounting information supporting each transaction is complete.

The principle of Unit of Account provides for a single currency to be used in all transactions of the Union. However, before the introduction of the single currency and the establishment of the “own resources” system, this principle did not exist. When the financing of the European Community’s budget was based on the contributions of the Member States, there were procedures regarding the payment of the contribution by each Member State. According to these, the contributions were placed at the disposal of the Community in the national currency of the Member States and they were deposited in the national Treasuries or other authorised bodies. These funds retained the value corresponding to the parity, at the date of deposit, in relation to a unit of account determined by the Council of Ministers. Until 1977 the budget was drawn up in units of account based on gold parity, which were replaced in

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<sup>80</sup> Committee of Independent Experts, *Second Report on the Reform of the Commission: Analysis of current practice and proposals for tackling mismanagement, irregularities and fraud*, 1999, 130.

1978 by the European unit of account, based on a basket of Community currencies. This was, in turn, replaced, in 1981, by the European Currency Unit, which was composed of the sum of specified amounts of the currencies of the Member States.<sup>81</sup> The introduction of the euro made all these procedures obsolete.

It is interesting to note that the rule/principle of Unity has been one of the bases used for the conflicts between the European Parliament and the Council of the European Union, in exercising their respective roles within the framework of the budgetary procedure (see below). More specifically, the European Parliament rejected the draft budget for the financial year 1980 because, inter alia, the European Development Fund and all the Communities lending and borrowing activities were not included in the budget by the Council.<sup>82</sup> Also the European Parliament had accused the Council of not entering all the necessary appropriations in the budget of the financial year 1986 in order to cover the expenses of the enlargement of 1985 (entry of Spain and Portugal in the European Community).<sup>83</sup> These conflicts have set the stage for the existing framework on the Budgetary Procedure of the Union.

#### V. The Budgetary Procedure: A test of wills and a balance of powers

The budgetary procedure, ie the procedure according to which the budget of the European Union is established and enacted, has always been seen as the “jewel of the crown”, in the competition that has been – and still is – noted within the institutional system of the European Union.

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<sup>81</sup> A.G. Toth, *op. cit.* p. 88-89.

<sup>82</sup> Ch. Sopwith, *Legal Aspects of the Community Budget*, 17 *CMLR* (1980) 340.

<sup>83</sup> Case 34/86, *Council of the European Communities v. European Parliament*, [1986] ECR 2155, at 2209.

This procedure entails the following stages:<sup>84</sup>

- First stage: The Commission sets the maximum rate of increase in non compulsory expenditure by the 1<sup>st</sup> of May, every year.
- Second stage: All European institutions prepare their expense estimates and forward them to the Commission by the 1<sup>st</sup> of July, every year.
- Third stage: The Commission consolidates the estimates of the institutions and it adopts the preliminary draft budget by the 1<sup>st</sup> of September, every year.
- Fourth stage: The Council examines the preliminary draft budget (first reading of the Council) and it establishes, by qualified majority, the draft budget, by the 5<sup>th</sup> of October every year, which is then sent to the Parliament.
- Fifth stage: The Parliament, within 45 days of receipt of the draft budget, examines it (first reading of the Parliament). If it makes no amendments, the budget is considered adopted. If it makes amendments, the draft budget is sent back to the Council. These amendments may be made by absolute majority of the votes cast if they refer to obligatory expenditure and by majority of members if they refer to non obligatory expenditure.
- Sixth stage: The Council, within 15 days of receipt, examines the amendments of the Parliament (second reading of the Council). If it does not modify the draft budget any more, the budget is considered adopted. If it modifies the draft budget, this is sent once more to the Parliament. These amendments may be made by qualified majority.
- Seventh stage: The Parliament examines the amendments made by the Council (second reading of Parliament). It can modify provisions, by majority of its members and 3/5 of the votes cast, regarding only the non compulsory expenditure.
- Eighth stage: The President of the Parliament declares that the budget has been adopted.

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<sup>84</sup> See Art. 272 EC Treaty and Art. 31-39 of Council Regulation 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities, OJ 2002 L 248/13-14.

In any case, the European Parliament, acting by a majority of its Members and two thirds of the votes cast, has the right, based on important reasons, to reject the draft budget and ask for a new draft to be submitted to it.

The decisive involvement of the Parliament in the budgetary process was introduced by the so called Budgetary Treaties. The first was the Treaty amending certain budgetary provisions of the Treaties establishing the European Communities and of the Merger Treaty, signed in 1970.<sup>85</sup> The necessity for signing this Treaty was based on the introduction of the own resources system. More specifically, this introduction meant that controls exercised previously by the national parliaments over national lump-sum contributions were lost, and this required strengthening the budgetary powers of the European Parliament in order to establish democratic control over the Community budget since that control could not be exercised at national level - in other words replacing national parliamentary accountability with a similar accountability at Community level.<sup>86</sup> The amendments introduced by this Treaty partially democratised the budgetary process by granting the Parliament the power to give the Commission a discharge in respect of the implementation of the budget along with the Council, as well as to have the final say regarding the non-compulsory expenditure.<sup>87</sup>

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<sup>85</sup> OJ 1971, L 2/1.

<sup>86</sup> D.A.C. Freestone, J.S. Davidson, *The institutional framework of the European Communities* (1988), 118, A.G. Toth, *op. cit.*, p. 61.

<sup>87</sup> F. Wooldridge, M. Sassella, Some recent legal provisions increasing the budgetary powers of the European Parliament and establishing a European Court of Auditors, 2 *LIEI* (1976), 13-14.

These amendments did not satisfy the European Parliament and a long interinstitutional political debate was initiated.<sup>88</sup> The result was the signing, in 1975, of the second Treaty amending certain financial provisions of the Treaties establishing the European Communities and of the Merger Treaty.<sup>89</sup> According to this Treaty, the Parliament's right to reject the draft budget and ask for a resubmission was confirmed, *expressis verbis*, and also the authority to grant the Commission a discharge for the implementation of the budget was conferred exclusively to the Parliament.<sup>90</sup>

The quest of every European institution for authority over the Community budget is understandable. This authority is analysed to the following rights/powers: a) the right/power to create revenue, b) the right/power to authorise expenditure, c) the right/power to approve the budget as a total and d) the right/power to control the budget's implementation.<sup>91</sup>

Such powers are crucial, considering the operation of the budget in the institutional framework of the European Union. More specifically, the Community budget and its structure are the global expression of the ideological content, in political and economic terms, of the European Communities.<sup>92</sup> Consequently the budget is the area of testing the overall institutional balance within the European Union,<sup>93</sup> due to the various levels of political sensitivity demonstrated by the European institutions on all

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<sup>88</sup> For more details regarding this process see F. Wooldridge, M. Sassella, *op. cit.*, p. 15-23.

<sup>89</sup> OJ 1977, L 359/1.

<sup>90</sup> A.G. Toth, *op. cit.*, p. 61-62.

<sup>91</sup> D. Strasser, *op. cit.*, p. 1.

<sup>92</sup> P.K. Ioakimidis, *The Transformation of the EEC* (1988), 45.

<sup>93</sup> P.K. Ioakimidis, *op. cit.*, p. 46.

Community issues.<sup>94</sup> Furthermore the budget is the point of balance of the conflicts of interest of the various Member States.<sup>95</sup> However, there has been also another approach, according to which the Community budget is not a mere global expression of the policies and priorities of the Communities, but also a means, of fundamental importance, for supporting Community policies as a whole.<sup>96</sup> In any case, having authority over the budget allows for a more powerful position in the institutional system and hierarchy of the European Union.

The result of such institutional competition is the complexity of the budgetary process. Also this competition has led to judicial conflicts, between the Parliament, the Council and the Commission. Originally such cases were removed from the European Court of Justice's Register after political compromises.<sup>97</sup> Two possible reasons have been identified for this, a legal and a political.

The legal reason comprised two factors. The first was the Council's awareness that the Budgetary Procedure established by the EC Treaty was so complicated that the Council had to lay down an internal code of rules in order to make this procedure operate more smoothly. The second factor was the uncertainty, which existed till

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<sup>94</sup> D. Seremetis, The budget of the European Union in N. Maravegias, M. Tsinisizelis (eds), *The integration of European Union* (1995) 318.

<sup>95</sup> D. Seremetis, *op. cit.*, p. 317.

<sup>96</sup> L. Kolte, *op. cit.*, p. 488.

<sup>97</sup> Case 48/81, *Federal Republic of Germany v Commission of the European Communities*, not reported, Case 72/82, *Council of the European Communities v European Parliament*, not reported, Case 73/82, *Council of the European Communities v Commission of the European Communities*, not reported, Case 377/87, *European Parliament v Council of the European Communities*, [1988] ECR 4017, Case 383/87, *Commission of the European Communities v Council of the European Communities*, [1988] ECR 4051.

1986, about the ECJ's power under Art. 230 to review the legality of acts of Parliament.<sup>98</sup>

The political reason was based on the background of the two institutions' (Parliament and Council) involvement in the Budgetary Procedure. That of the Parliament refers to the historically established role of parliamentary institutions in determining budgets,<sup>99</sup> aiming at the same time to intensify its requests for new legislative powers and more democracy in the Community. That of the Council refers to the fact that it was the Member States, which gather and place the Community's own resources at the Community's disposal. The Member States are practically financing the Community, in the Council's opinion, therefore the institution which represented them (Council) is entitled to the greater share of decision making power over the budget.<sup>100</sup> A relevant remark is that discrepancy between the rhetoric and the practice of the Member States can be identified. The Member States publicly encourage the Parliament to become more involved in all the decision making procedures of the Community but privately they take steps constraining the Parliament's greater ambitions.<sup>101</sup>

The Parliament gave a clear indication of its intention to participate actively and substantively in the budgetary process in 1980, when it used its right to reject the entire draft budget (Art 272 para 8 of the EC Treaty) because it did not agree with the amounts of resources distributed by the Council between compulsory and non compulsory expenditure for that year.<sup>102</sup>

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<sup>98</sup> Opinion of Advocate General Mancini in Case 34/86, *Council of the European Communities v. European Parliament*, [1986] ECR 2155 at 2157.

<sup>99</sup> L. Trotabas, J-M Cotteret, *Droit budgétaire et Comptabilité publique* (1995), 16-23.

<sup>100</sup> Opinion of Advocate General Mancini in Case 34/86, *Council of the European Communities v. European Parliament*, [1986] ECR 2155 at 2157.

<sup>101</sup> H. Wallace, A European Budget made in Strasbourg and unmade in Luxembourg, 6 *YBEL* (1986), 266.

<sup>102</sup> Ch. Sopwith, *op. cit.*, p. 340-345.

The distinction between compulsory and non compulsory expenditure has been the core of the institutional conflicts regarding the Budgetary procedure. This distinction in Community expenditure was introduced in order to safeguard the powers of the Council as legislator and policy maker, but it has caused repeatedly several discussions, not at a legal level, but at a political level, regarding the priorities promoted and financed by the Community, for instance agricultural policy (compulsory expenditure) over structural funds' operations (non compulsory expenditure) or vice versa.<sup>103</sup>

Within the framework of the Budgetary procedure, the Council has the final say about compulsory expenditure while the Parliament has the final say about non compulsory expenditure. These two categories of expenditure are defined in Art. 272 para 4 of the EC Treaty. The compulsory expenditure is expenditure necessarily resulting from the Treaties or from acts adopted in accordance therewith. The non compulsory expenditure is all the other expenditure of the Union.

These definitions were not and still are not satisfactory. In order to reach an agreement, a conciliation procedure was introduced by a joint declaration of the European Parliament, the European Commission and the Council in 1975.<sup>104</sup> According to this, representatives of both the Parliament and the Council were to meet before the two readings of the draft budget in order to exchange and explain views and opinions.<sup>105</sup> This procedure however was not enough.

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<sup>103</sup> P.J.G.Kapteyn, P. Verloren van Themmat, (edited by L. Gormley), *op. cit.*, p. 379-382.

<sup>104</sup> OJ 1975, C 89/1.

<sup>105</sup> K. Stefanou, *European Integration* (1991) 101-102, Sopwith, *Legal Aspects of the Community Budget*, 17 *CMLR* (1980) 325

The Parliament had presented its own interpretation according to which only expenditure to which a third party has a legal claim may be regarded as compulsory expenditure.<sup>106</sup> The Council did not present a counter argument but it did not accept this definition either. However, in their Joint Declaration of 1982 on the Community Budgetary procedure<sup>107</sup> the Council and the Parliament defined as compulsory expenditure the Community's legal obligations towards third parties, who may be either third countries or Member States, individuals or corporations. This definition included for instance expenditure about the Common Agricultural Policy or the administrative expenditure of the institutions. In Art. 16 of the Interinstitutional Agreement of 1988 on Budgetary Discipline and Improvement of the Budgetary procedure,<sup>108</sup> the two institutions agreed to consider the expenditure incurred for the Structural Operations and the policies with multiannual allocations such as the Integrated Mediterranean Programmes and the research policies as non compulsory expenditure.<sup>109</sup> Also the operational expenditure for the Common Foreign and Security Policy is non compulsory. Despite these arrangements, however, there have still been differences of opinion about some expenditure. For instance, the UK's budgetary rebate is considered by the Council as compulsory expenditure while the Parliament considers it as non compulsory expenditure.<sup>110</sup>

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<sup>106</sup> P. Dankert, The Joint Declaration by the Community Institutions of June 1982 on the Community budgetary procedure, 20 *CMLR* (1983) 705

<sup>107</sup> OJ 1982, C 194/1.

<sup>108</sup> OJ 1988, L 185/33.

<sup>109</sup> P. Zangl, The Interinstitutional Agreement on Budgetary Discipline and Improvement of the Budgetary Procedure, 26 *CMLR* (1989) 675-685.

<sup>110</sup> P. Dankert, *op. cit.*, p. 708

In addition to these definitions, the 1982 Joint Declaration replaced the previous conciliation procedure with another, according to which the presidents of the Commission, the Parliament and the Council meet and exchange their views over the draft budget before the Council's first reading. These meetings may result even to an increase of the maximum rate set by the Commission with regard to non compulsory expenditure. The Declaration's purpose was to reduce the tension between the Council and the Parliament, but the difficulty of the task was acknowledged immediately and nothing could be predicted.<sup>111</sup>

Another issue, of a more procedural nature, concerns the interpretation of Art. 272 paras 6, 8 and 9 of the EC Treaty, and more specifically the interpretation of the majorities mentioned in these articles. These majorities refer a) to the competence of the Parliament to amend or reject the modifications made by the Council to the draft budget regarding non-compulsory expenditure (Art. 272 para 6), b) the competence of the Parliament to participate to the increase of the maximum rate of non-compulsory expenditure included in the budget (this amount is established initially by the Commission and it may be amended by an agreement between the Council and the Parliament (Art. 272 para 9), and c) the competence of the Parliament to reject the draft budget (Art. 272 para 8).

With regard to the first two cases (paras 6 and 9 of Art. 272), the wording of the relevant provisions requires the majority of the Parliament's Members and three fifths of the votes cast. This generates the following dilemma: do both these limitations refer to the majority required for the adoption of the Parliament's decision or does the

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<sup>111</sup> P. Dankert, *op. cit.*, p. 706-712.

first limitation refer to the necessary quorum and the second (regarding the three fifths) to the majority required for the adoption of the decision?<sup>112</sup> It is obvious that the first method of calculation requires much bigger majorities than the second. Today the European Parliament has 786 members. If the first method is accepted (both limitations refer to the majority required for the adoption of the Parliament's decision) then that means that the decisive majority must consist of both a) a majority of 394 votes and b) three fifths of the overall number of votes cast. If the second method is adopted (the first limitation refers to the quorum and the second to the majority required for the adoption of the Parliament's decision) then that means that it would be sufficient to have 394 Members of the Parliament present at the time of the vote and, if all of them vote, then three fifths of the votes cast (ie 236 votes) will be enough to adopt the decision. The problem is similar for Art. 272 para 8 according to the wording of which, a majority of the Parliament's Members and two thirds of the votes cast are sufficient for the Parliament to reject the draft budget.<sup>113</sup> In that case, according to the first method of calculation mentioned above (both limitations refer to the majority required for the adoption of the decision), the decisive majority will consist of at least 394 votes and of two thirds of the overall number of the votes cast. According to the second method of calculation (the first limitation refers to the necessary quorum while the second refers to the majority required for the adoption of the decision), a quorum of 394 members of Parliament is sufficient and if all those present vote a majority of two thirds of the votes cast (ie 263 votes) is required to reject the draft budget. The Council and the Commission consider the first method of calculation as more correct, arguing that if the second method of calculation is accepted, then according to Art. 272 para 4 the Parliament can modify the non

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<sup>112</sup> Ch. Sopwith, *op. cit.*, p. 323.

<sup>113</sup> Ch. Sopwith, *op. cit.*, p. 323.

compulsory expenditure using obligatorily the absolute majority of its Members (394 votes) while according to Art. 272 para 8 referring to the rejection of the draft budget -something much more important than amending the non compulsory expenditure- the Parliament will need only a two thirds majority of the votes cast, which is 263 votes out of 367 votes (since the first limitation would be considered to refer to the quorum). Consequently, rejecting the draft budget would require less votes than simply amending it.<sup>114</sup> The Parliament, nevertheless, has considered the second method of calculation of the votes as more correct, and it has applied it, whenever the provisions in question were used. It seems that the Parliament's approach is more correct. The wording of the relevant provisions seems to refer first to the quorum which will allow legally to the Parliament to adopt a decision and then to the percentage of the votes required for the actual adoption of the decision (three fifths or two thirds, depending on the provision used). That is the purpose of the use of different terms in the text of the provisions in question, as at first the Treaty refers only the Member of the Parliament and afterwards it refers to the votes cast.

Such conflicts about the budgetary process eventually were brought before the European Court of Justice, which was called to rule on the legality of the Communities' and later the Union's budget. The first question arising about the judicial review over the Budgetary Procedure is whether the ECJ has any jurisdiction to review the budget or not. This question can be answered in both a political and a legal context.

With regard to the political context, it has been argued that it would be perilous to entrust the resolution of constitutional conflicts (such a conflict within the framework of the Budgetary Procedure) to the judiciary, which already had excessive powers

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<sup>114</sup> Ch. Sopwith, *op. cit.*, p. 323-324.

within the Community's institutional framework.<sup>115</sup> Any judgements which would effect the substance of the Budgetary procedure would mean that the ECJ would substitute itself for one of the institutions comprising the Budgetary Authority. This would promote the ECJ to the rank of financial authority and would make credible all accusations against the ECJ that it is practically a government of judges.<sup>116</sup>

As for the legal context, the ECJ has declared that it could not intervene in the process of negotiation between the Council and the Parliament during the Budgetary Procedure. It did not have to consider to what extent both institutions' attitude prevented them from reaching an agreement over the budget.<sup>117</sup> The ECJ has only to verify the conformity of the budgetary operations with the provisions of the Treaty.<sup>118</sup> It is for the ECJ to ensure that the institutions comprising the Budgetary Authority keep within the limits of the powers conferred upon them by Community law.<sup>119</sup> More specifically it has to ensure that in the context of the dialogue, the Institutions (Parliament – Council) do not ignore the rules of law and do not exceed their discretionary power in a manifestly wrong or arbitrary way.<sup>120</sup>

Seeing the political and the legal context, it may be argued that they are complementary to each other. It is politically incorrect to have a judicial institution involved substantively in financial matters of constitutional nature such as the enactment of a budget, especially if this judicial institution, like the ECJ, is accused of having excessive powers. However it is perfectly legal (according to Community law) for the ECJ to examine whether the relevant procedural framework, as prescribed by the Treaty, has been adhered to. It is a political responsibility for the

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<sup>115</sup> Opinion of Advocate General Mancini in Case 34/86, *Council of the European Communities v. European Parliament*, [1986] ECR 2155 at 2157.

<sup>116</sup> Opinion of Advocate General Mancini in Case 34/86, *Council of the European Communities v. European Parliament*, [1986] ECR 2155 at 2185.

<sup>117</sup> Case 34/86, *Council of the European Communities v. European Parliament*, [1986] ECR 2155 at 2210-2211.

<sup>118</sup> M. Bazex, *La contôle de la Cour de Justice des Communautés Européenes sur les Acts Budgétaires*, 23 *Rev.Trim.Dr.Europ.* (1987) 465.

<sup>119</sup> Case 34/86, *Council of the European Communities v. European Parliament*, [1986] ECR 2155 at 2210.

<sup>120</sup> Case 204/86, *Greece v. Council of the European Communities*, [1988] ECR 5323 at 5339.

Council and the Parliament to behave in such a way that an agreement can be reached between them over the budget, but the actual agreement is a requirement prescribed by Community law and the reaching of it can be examined by the ECJ. Therefore the ECJ has jurisdiction to rule on disputes over the Union's budget.<sup>121</sup>

The intense conflicts over the budget and the Budgetary Procedure were not difficult to be foreseen by the founding Member States of the European Community. Therefore they could not exclude the possibility that that due to such serious disagreements on the contents of the Community's budget that at the beginning of the financial year the budget might not be established. The history of the European Community has demonstrated that this is not a mere possibility but it has become occasionally a reality. Art. 273 EC Treaty provides the European Union with the assurance that, in case of the budget not being voted, its activities will be continued, their funding being based on the system of "provisional twelfths".

This system consists of the following elements:<sup>122</sup>

- An automatic authorisation for monthly expenditure in respect of any chapter or other subdivision of the budget, provided that this expenditure does not exceed the lower of the following figures: either one twelfth of the budget appropriations for the preceding financial year or one twelfth of the budget appropriations provided for in the draft budget in course of preparation;

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<sup>121</sup> For a detailed analysis of the judicial review of the Budgetary Process see D. Skiadas, *Judicial Review of the Budgetary Authority during the enactment of the European Union's budget*, 4 *EIoP* (2000), <http://eiop.or.at/eiop/texte/2000-007a.htm>.

<sup>122</sup> J. Pipkorn, *Legal Implications of the absence of the Community Budget at the beginning of a financial year*, 18 *CMLR* (1988) 145-146.

- The power given to the Council, acting by a qualified majority, to derogate under certain conditions from the above limitation and authorise expenditure in excess of one twelfth;
- The power given to the European Parliament, acting by a majority of its members and three fifths of the votes cast, to adopt a different decision from that of the Council in respect of expenditure in excess of the one twelfth, if that decision refers to non-compulsory expenditure.
- The power given to both the Council and the European Parliament to include in the above mentioned decisions, the measures relating to the resources that will finance the expenditure in excess of the one twelfth.

The “provisional twelfths” system combines elements from various constitutional and budgetary traditions of the Member States. More specifically, there are cases where the Parliament votes pre-budgets on a monthly basis in order to establish provisional appropriations, which are later consolidated in the regular budget, or cases where the appropriations of the preceding financial year for expenditure, which is considered unavoidable, are renewed automatically. The version adopted by the Union starts with an automatic renewal of appropriations, which are limited not according to the nature of the expenditure for which these appropriations are intended, but by means of monthly fractionalisation.<sup>123</sup>

This system has been used repeatedly as in 1964, 1968, 1980, 1982, and 1984, for several reasons, the budget was not voted in time.<sup>124</sup> Although legally the absence of the budget has been covered, such a perspective is always problematic. It will mean that all Community activity will be considerably restrained as it will be functioning at

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<sup>123</sup> J. Pipkorn, *op. cit.*, p. 146-147.

<sup>124</sup> J. Pipkorn, *op. cit.*, p. 147, Ch. Sopwith, *op. cit.* p. 340-345, P.J.G.Kapteyn, P. Verloren van Themmat, (edited by L. Gormley), *op. cit.*, p. 385.

the previous year's levels of expenditure, and if the budget's approval is further delayed it will oblige the competent European Institutions to process two budgets simultaneously, an operation quite onerous and time-consuming.<sup>125</sup>

Finally, it is necessary to distinguish between the absence of the budget at the beginning of the financial year and the annulment of the budget during the financial year. It has been ruled that in case of the annulment of the budget, in order to ensure the continuity of the European public service as well as to maintain legal certainty, the effects of the annulled budget are maintained in force, although the budgetary procedure must be resumed from the point which caused the annulment, in order to lead to the adoption of a new budget.<sup>126</sup> Art. 273 EC Treaty is not used in such an eventuality.

## VI. The Negotiations on the 2007-2013 Financial Perspectives: A Critical Turn

The political context of the negotiations on the 2007-2013 Financial Perspectives was full of tensions. As early as 2003 the six net contributing Member States (i.e those whose contributions in the EU Budget are higher than the sums they receive from the budget) declared their will to limit the EU Budget's size.<sup>127</sup> At the same time, a report by a Group of Independent Experts, under the supervision of Andre Sapir, commissioned by the European Commission, studied the financial system of the European Union and concluded that the European budget has developed into a historical relic, since the areas of expenditure reflected outdated needs of the Union, therefore a radical restructuring was in order.<sup>128</sup> This of course caused reactions from those benefiting from the existing distribution of EU resources, mainly those involved in agriculture and the Member States with the poorer areas of Europe. Thus the stage was set for an intense political conflict. The European Commission tried to put

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<sup>125</sup> D.A.C. Freestone, J.S. Davidson, *The institutional framework of the European Communities* (1988), 124.

<sup>126</sup> Case 41/95, *Council of the European Union v. European Parliament*, [1995] ECR I-4411, at 4440-4441.

<sup>127</sup> T. Szemler, *op. cit.*, p. 9, I. Begg, Fr. Heinemann, *op. cit.*, p. 2.

<sup>128</sup> Report of Independent High Level Group, *An Agenda for a growing Europe – Making the EU Economic System Deliver*, July 2003.

forward a proposal that would compromise the various points of view, on a basis of identifying new priorities for the Union and of increasing the ceiling of the appropriations in order to meet the cost of these priorities.<sup>129</sup> These included the promotion of the Lisbon Strategy focusing on sustainable growth, through competitiveness and cohesion for growth and employment, the better management of natural resources through policies in the area of agriculture, fishery, and environment, the consolidation of the European identity through the enhancement of European citizenship while at the same time supporting European culture and diversity, and the promotion of the Common Foreign and Security Policy by reinforcing the Union's role in the international scene.

This proposal was examined during the meeting of the European Council in Brussels, on 15-16 June 2005. However, while there has been political agreement on the substance of the new priorities, the financial aspect of the proposal was debated and the result was that no overall agreement was reached on the Financial Perspectives.<sup>130</sup> The thorny issues were the amount of the net contribution of some Member States, the UK rebate and the expenditure on the Common Agricultural Policy.<sup>131</sup>

The failure of these negotiations, in conjunction with the rejection of the Constitutional Treaty in France and the Netherlands, initiated a crisis within the Union's institutions, which was reflected in all sectors of EU activity. The lack of an agreement had serious political, budgetary and technical-managerial implications.

The failure to agree was seen as a huge political set back for the EU. Not agreeing a framework for the first time since 1988 send an alarming signal that the enlarged EU is not working, and that it cannot respect its commitments, most notably to the new Member States as regards cohesion policy. Furthermore the EU's broader policy objectives were questioned, i.e., the relaunch of the Lisbon agenda, thus creating a climate of uncertainty around attempts to boost the European economy. Divisions between the Member States were clearly registered, thus undermining solidarity amongst them. The adoption of the principle "nothing is agreed until everything is

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<sup>129</sup> European Commission, Building our common future, policy challenges and budgetary means of the enlarged union, COM(2004)101 final, European Commission, Financial Perspectives 2007 – 2013, COM (2004) 487 final.

<sup>130</sup> European Council, Presidency Conclusions, Brussels 15-16 June 2005, Doc 10255/1/2005.

<sup>131</sup> T. Szemler, *op. cit.*, p. 10.

agreed” was a real risk of a major institutional crisis and a paralysis of all decisions in the European Union.

At a budgetary basis, the lack of agreement postponed the adoption of multi-annual programmes, depriving all funding operations from their legal bases (including structural funds, research, education and training, trans-European networks, the protection of external borders, external relations, etc.). The 2000-2006 Interinstitutional Agreement on budgetary discipline could be prolonged, but its lower financial ceiling would reduce the resources available for 2007 by 1,2 billion Euros, compared to those for 2006. Alternatively, the annual fixing of the budget – till an agreement is reached – would lead to an average ceiling of 119 billion Euros for 2007, which was equivalent to the ceiling for 2006, but this option would eliminate any possibility of taking into account the additional needs of the new Member States, in terms of cohesion policy. The lack of legal bases would make all expenditure transactions impossible. Especially with regard to the Structural Funds, multi-annual programming would be impossible and also the basis of allocation of the Funds’ resources among Member States would expire at the end of 2006.

These factors were considered very carefully in the second half of 2005. New proposals were submitted, focusing mainly on keeping the ceiling of the appropriations limited, in terms of EU GNI, and providing each member state with some special treatment, on an issue that was of great interest to it. For instance, a number of special provisions was included in the Financial Perspectives text, which allocated additional funds to Member States without being subject to the capping rules, or additional allocations by the Structural Funds were set for various regions, or the co-financing rate on behalf of the Union, was increased for some Member States. The result was the agreement during the meeting of the European Council in Brussels, on 15-16 of December.<sup>132</sup> According to the new Financial Perspectives, the total appropriations were set to 862 billion euros, which represent 1.045% of EU GNI, for the period 2007-2013. Out of this sum, the Structural Funds were allocated 308 billion euros, while the Common Agricultural Policy, along with actions supporting the environment, were allocated 371 billion euros.

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<sup>132</sup> European Council, Presidency Conclusions, Brussels 15-16 June 2005, Doc 15914/1/2005 and Doc 15915/2005.

However, this agreement simply solved a problem of the Union, at a short-term, or even medium-term, basis. It has been noted that the result of the European Council's summit on December 2005 has been a temporary solution, which created a jungle of specific regulations and conditions, based on the pillars of the agreements of the previous programming periods, without any clarity.<sup>133</sup> The outcome of the negotiations was so obscure that even the European Parliament, during its initial examination of the agreement, on January 2006, rejected it and it took six months of long negotiations before reaching a new Interinstitutional Agreement on budgetary discipline and sound financial management.<sup>134</sup> It has been noted that the final compromise has not been so radical, compared to the original Commission proposal, given the reduction of the overall volume of expenditure, as well as the fact that the final structure of expenditure gives relatively more weight to the financing of agriculture (CAP) and reduction of development disparities (cohesion policy) and less weight to the Lisbon strategy objectives (competitiveness policy), other internal policies (freedom, security, justice and citizenship) and external policies (enlargement and development aid to non-EU and non-candidate countries).<sup>135</sup>

For some, the most important element of the new Financial Perspectives agreement, has been the commitment undertaken by the Union's Institutions to reassess the financial framework of the 2007-2013 period, by reviewing all aspects of EU spending and resources, and prepare a relevant report in 2008/2009. This "review clause" allowed for mutual concessions to be made during the negotiations and it also demonstrated that the Member States have, at last, realised the need for further budget reform.<sup>136</sup> Others have adopted a more pessimist approach, noting that there have been in the past very well documented studies on reforming the European budget, without, however, resulting in an effective solution.<sup>137</sup> Nevertheless, it seems that, at least, the European Parliament, believes in this reforming effort. For this reason, it has already identified issues that need to be tackled such as the complexity of the calendar of the political agenda of the Union (Ratification of the Lisbon Treaty, the European

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<sup>133</sup> T. Szemler, *op. cit.*, p. 11-12.

<sup>134</sup> OJ 2006, C 139/1.

<sup>135</sup> M. Mrak, V. Rant, Financial Perspective 2007-2013: Domination of national interests, EU-CONSENT, EU-Budget Working Paper No 1, July 2007, pp. 5-6.

<sup>136</sup> I. Begg, Fr. Heinemann, *op. cit.*, p. 4.

<sup>137</sup> T. Szemler, *op. cit.*, p. 11.

Parliament elections, the appointment of a new Commission, reform of the European budget, etc), the resolving of left-overs from the previous programming period, the mid-term evaluation of the programmes for the current programming period and the preparation of the next programming period.<sup>138</sup> It is interesting to see some of the suggestions that have been put forward within the framework of that review.

## VII. The 2008/2009 EU Budget Review: the Quest for the Holy Grail of the Union

The discussion on the European Budget Review has already indicated that there is scope for improvement for the Union's financial mechanism. It is a discussion that sometimes goes back to basics, a characteristic caused by two interrelated factors. The first is the vagueness of the mandate given by the European Council with regard the review of the budget, using an ambiguous wording which did not clarify neither the scope nor the usefulness of the review.<sup>139</sup> The second is the fact that addressing such a complicated issue requires taking a step backwards and examining the entire structure and operation of the EU, before putting forward proposals for the reform of this financial system. Topics such as the modes of governance used by the Union's institutions (i.e. the regulatory function within the framework of the "Community method" in areas of EU exclusive competence, the budgetary function with regard to financing policies, the coordinating function with regard to the implementation of EU policies such as the Lisbon Strategy or the Growth and Stability Pact, etc) are being studied in order to be used in formulating a proposal for a new financial system of the Union.<sup>140</sup>

So far, the review process has four characteristics, all resulting from the Commission's approach to the issue. It is an open procedure and all those interested, at local, national and international level, may submit their contributions, thus participating in the broad consultation process. Priority has been given, so far, to EU expenditure, despite the fact that the revenues must be examined as well. The review has adopted a policy-driven approach as all EU spending is being examined in the

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<sup>138</sup> European Parliament – Committee on Budgets, Working Document on the 2007-2013 Multiannual Financial Framework review: First reflections, Doc PE 392.301v02-R. Böge, 31.08.2007

<sup>139</sup> E. Rubio, *EU Budget Review: Addressing the Thorny Issues*, Policy Paper no 32, Notre Europe, 2008, pp. 3-5.

<sup>140</sup> I. Begg, *The 2008/9 EU Budget Review*, EU-CONSENT, EU-Budget Working Paper No 3, March 2007, pp. 4-7.

light of EU political priorities and challenges. And there is a considerable effort to separate the 2008/2009 review from the preparation of the negotiations for the next programming period, after 2013. There are, however, issues to be settled such as the timing of the production of the final report requested by the European Council, the use of the results of the consultation process by the Commission, and of course the contents of the final report, especially with regard to its orientation (i.e. will it be an analysis of options for the future, will it entail specific discussion on detailed issues or will it maintain the analysis at a general level, etc).<sup>141</sup> In an overall approach, it has been noted that in order for the review to be successful, it must be inspired by the early reforms in the 1980s: As those reforms were affiliated with significant political choices, such as the establishment of the Single Market, and they resulted in considerable changes in the EU Financial system, the current review must be related to a new political agenda, such as the Lisbon Strategy, and it needs to focus on the structural problems by tackling all dimensions of the EU budgetary system (revenue, expenditure, procedures).<sup>142</sup>

Despite these procedural questions, the substance of the discussion so far, in the context of the review, has indicated that there is a serious effort of actually formulating an interesting and useful proposal for the Union's financial system.

Starting with the EU revenue, the first question to arise refers to the real nature of the Union's own resources. A careful study of the system reveals that more than ninety percent of the European Union budget is financed through national contributions linked to national Treasuries, rather than from taxes levied on a European Union-wide fiscal basis. All four types of revenue are related, one way or another, to the financial operations of the Member States: the custom duties, the import levies on agricultural goods and even more the VAT related revenue and the contribution on each member state's GDP, therefore leading to the characterisation "pseudo own resources", aiming to cover the financial need jointly borne by the Member States.<sup>143</sup>

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<sup>141</sup> For a detailed analysis of all the issues relating to the review process see E. Rubio, *op. cit.*, pp. 8-12.

<sup>142</sup> See E. Rubio, *op. cit.*, pp. 13-22.

<sup>143</sup> J. Le Cacheux, *European Budget – The poisonous budget rebate debate*, Studies and Research No 41, Notre Europe, 2005, p. 5.

This situation has always resulted in discussions over budgetary reform being dominated by considerations of the net balances and net contributions on behalf of some Member States, given that their share in the funding of the Union is excessive, compared either to the benefits they receive or the contribution of other Member States. These considerations are usually based on calculations of net budgetary balances which consist on a) totalling all payments made by a country through its Treasury to Union's budget (i.e. these are revenues from the various types of the own resources system, which are collected on the country's soil and have been established by legislative instruments adopted by the country's parliament) in the debit column and b) totalling all expenditure made by the Union in favour of the same country (i.e. payments to its farmers, structural assistance for various regions of the country, etc) in the credit column.<sup>144</sup> History has shown that such cases lead to compromises under the headings "rebate", or "special payments", or "ad hoc spending commitments", etc.<sup>145</sup> The European Council is still haunted by the echoes of Mrs M. Thatcher's famous declaration "I want my money back", during the Fontainebleau Summit in 1984, a meeting which resulted in the establishment of the UK budget rebate.

The current system of own resources has been established based on the principle of financial solidarity amongst the Member States, in the sense that certain actions, policies, goods and public or collective services are better done acting jointly, therefore is it necessary to finance these actions by pooling resources in the framework of a common budget, operating under an institutional scheme influenced by the principle of subsidiarity.<sup>146</sup> The system itself has been found to have certain advantages, leading to the conclusion that it works well enough. First, it allows for an easy prediction of each Member State's contribution, second, it is based on the respect of the "ability to pay" principle by providing that the Member States will pay equal proportions of their income and third, it provides for the Member States to be committed only to transferring money in order to meeting the Union's agreed expenditure.<sup>147</sup>

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<sup>144</sup> J. Le Cacheux, *op. cit.*, p. 13.

<sup>145</sup> I. Begg, *op. cit.*, p. 7-10, J. Le Cacheux, *op. cit.*, pp. 7-12.

<sup>146</sup> J. Le Cacheux, *op. cit.*, p. 3 and 24.

<sup>147</sup> I. Begg, *op. cit.*, p. 11.

However, it is obvious that this arrangement has certain loopholes that need to be addressed. The most prominent issue is the fact that the European budget has become highly vulnerable to nationalistic discourses of “*juste retour*”, i.e. the complaints of certain Member States for the size of their contributions to the budget and the possibilities for rebates.<sup>148</sup> Another disadvantage is the fact that the size of contributions is being determined according to the size of national political boundaries, thus leading to the inevitable result of making a distribution of budget expenditure according to geographical terms.<sup>149</sup> Finally, it has been noted that given the intergovernmental nature of transfers to the European budget and the unavoidably resulting tendency to balance net transfers across Member States as well as the unanimity rule in budget policy decisions gives every country a considerable amount of leverage, as it can withhold its contributions as a political ploy, or threaten to veto a EU-wide policy.<sup>150</sup> The course of events so far has demonstrated that, the current system, although useful when established, nowadays risks to systematically undermine European integration and weaken the European Union’s capacity to act on behalf of the collective public interest, representing its Member States as a whole.

Seeking an alternative solution to the existing own resources system has been another point of debate. Under the wording of the Treaty of Lisbon amending Art. 269 EC Treaty by inserting a new paragraph stipulating that “the Union shall provide itself with the means necessary to attain its objectives and carry through its policies”, a new perspective appears. An identical provision existed in Art. 53 of the Constitutional Treaty. Given that due to the above remarks there are justified doubts on the present system’s capacity of achieving this goal, the proposal of introducing a European Tax has been put forward.

In order to establish such a tax, certain criteria have been identified. From an economic point of view, this tax should avoid distortions and respect the principle of proportionality (tax is paid according to financial ability). The administrative process of collecting such a tax should be simple and cost-effective, i.e. not exceeding a prohibitive cost for its progress. Politically, such a tax would be better accepted if it

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<sup>148</sup> I. Begg, *op. cit.*, p. 11-12.

<sup>149</sup> I. Begg, *op. cit.*, p. 12, J. Le Cacheux, *op. cit.*, p. 24.

<sup>150</sup> I. Begg, *op. cit.*, p. 12-13.

focused on issues of EU political priorities, avoiding intrusion into nationally sensitive areas, or if it was destined to replace existing national taxes. Having a European Tax contributes in assuring funding for the Union, thus reinforcing its autonomy and conferring greater legitimacy on it. The issue of a tax corresponding to a territory within which it is imposed will also be settled, as there will be a horizontal implementation of the system in the EU context. Finally, such a tax would make the Union, as a fiscal entity, more transparent and visible to European taxpayers, improving the connection between representation and taxation at European level.<sup>151</sup> Of course, these elements should be seen in a more democratic context. The European Union, although built on the principle of democracy, has been well known for its democratic deficit.<sup>152</sup> In order for a European tax to be introduced, the budgetary authority of the European Parliament must be extended in order to cover decisions of the European Commission and the Council relating to the tax base, a base that should be related to the transfer of goods and services within the European Union and could possibly be a proportion of VAT. The collection of the European tax may be entrusted to national authorities however the tax base must be within the exclusive competence of the European institutions, which, in turn, must be accountable to the representatives of European citizens, on this issue.

Shifting focus on the expenditure of the European budget, it has been noted that the size of the European budget is small, compared to the sizeable public expenditure of the member states, but the “right” size of the budget depends on what the money is being spent on.<sup>153</sup>

Under the current arrangements, as noted above, there are still two major components of EU spending. The first is the cost of the Common Agricultural Policy. Although there is much criticism for this choice, the fact that most of the new Member States of the Union demonstrate a very high percentage of employment in the agricultural sector, will not allow for an option to reduce the expenditure on CAP. This is reinforced by the international economic environment, as it has been demonstrated

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<sup>151</sup> I. Begg, *op. cit.*, pp. 13-16. For an extensive analysis of the possibility of introducing a European Tax see J. Le Cacheux, *Funding the EU Budget with a genuine own Resource: The case for a European Tax*, Studies No 57, Notre Europe, 2007.

<sup>152</sup> See D.N. Chrysochoou, Democracy and the European Polity, in M. Cini (ed.), *European Union Politics*, Oxford University Press, 2007, pp. 360-374.

<sup>153</sup> I. Begg, Fr. Heinemann, *op. cit.*, p. 3.

during the workings of the Doha Round, which indicate a tendency of increasing agricultural subsidies in the interest of development in poor countries. Furthermore, the protection of food sufficiency and quality calls for investment, especially in an age where food related health hazards are quickly spread across the globe. Consequently, it seems that there is not much scope for changing the 2002 agreement on agriculture, as reached by the European Council in Brussels, before the end of the current programming period.<sup>154</sup> Alternatively, there are considerations of either changing the policy itself, i.e. reorienting the payments in a direction of rural development, in which all payments will not be direct but proportionate to the size of the farms, and the income capacity of the farmers, or even abolishing the entire common agricultural policy, in order to make room for free agricultural markets, in which any state subsidies will be monitored and evaluated closely.<sup>155</sup>

The second largest part of EU expenditure refers to the support of cohesion and regional policies. Despite all efforts, there are still criticisms about the effectiveness of the support provided by the Structural Funds, a support which lead to an increase of income in some regions, but only through a redistribution of resources instead of the implementation of a more substantive structural policy. For the 2007-2013 period, the introduction of the Lisbon Strategy as an element of preparing the various intervention may result in more positive outcomes.<sup>156</sup>

It seems, however, that the time is right for a more radical reform, focusing not only on the re-orientation of the objectives of the European budget's funding, i.e. the policies, but on the entire process of selecting a policy for funding. The existing process has been structured on certain stages which have become more of a formality, instead of substantive elaboration of political choices and opinions. The current sequence, including initial debates on the objectives of the budgetary settlement, the Commission's proposals and the Council's reactions, the exchange of views which can never be reconciled, the intensive efforts of the various Presidencies of the Council in order to reach a complex political agreement in which nobody really understands what they have actually agreed upon, and the indifference of the peoples

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<sup>154</sup> I. Begg, *op. cit.*, pp. 18-19.

<sup>155</sup> I. Begg, *op. cit.*, pp. 19-20.

<sup>156</sup> I. Begg, *op. cit.*, pp. 20-21.

of Europe, in the name of which all these take place, effectively blocks any prospect of reform.<sup>157</sup>

In order to escape from this stalemate, perhaps the most salient option is to adopt the Commission's suggestions, when preparing for the Constitutional Treaty. At that time the Commission identified the shortcomings of the Union's operation: lack of clarity, lack of accountability, lack of proximity, lack of effectiveness.<sup>158</sup> These shortcomings are more than obvious in the Union's current budgetary system. Addressing them calls for a new strategic option. The use of the principle of sound financial management, as analysed above, not only at the level of implementation of the budget, but also at the level of its preparation, may prove very positive. It is necessary to make a suitable ex ante evaluation of the use of the funds, using the three criteria, economy, efficiency, effectiveness. The corresponding questions to be answered within this new task are the following: What is the economic rationale behind the Union's expenditure? Is the goal achieved through the financing of the policy? Are there other more efficient mechanisms to achieve the goals set? The answers to these questions could lead to a budgetary structure which will focus on the real problems that need to be effectively tackled by the Union's activities. The information provided by the answers is clear and understandable, identifies the responsible authority, and sets the stage for an effective implementation of the relevant policy.

It is true that the status quo of European Integration, in terms of political, economic and institutional progress is very advanced. Therefore, the above proposal could be incorporated into an interdisciplinary approach of the entire issue of the European budget's reform. The first element of this approach is based on the theory of Fiscal Federalism.<sup>159</sup> There are elements of this theory that can set criteria useful for the identification of policies that can be pursued at EU level. The first refers to the gains that result in public spending, the quality of which can be improved by pooling resources, avoiding duplication and achieving economies of scale. The second entails the spillover effect that is registered when the expenditure made in one territory has

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<sup>157</sup> I. Begg, *op. cit.*, pp. 24-25.

<sup>158</sup> European Commission, Communication from the Commission – A project for the European Union, COM(2002) 247 final, Brussels, 22.5.2002, pp. 19.

<sup>159</sup> For an interesting analysis of the theory of Fiscal Federalism see S. Collignon, *The European Republic - Reflections on the Political Economy of a Future Constitution*; The Federal Trust/Kogan Page, 2003.

effects in other territories as well. The third refers to the variety of the fiscal capacity of the various Member States, as well as their managerial capacity, given that there are countries that can afford to invest money from their national resources in order to support cohesion policies, while others need the additional support from the Union. The fourth is the verification of the EU added value, i.e. all EU citizens benefit from the implementation of the selected policies, at a much larger scale than they would benefit from the implementation of policies at national level.<sup>160</sup>

But this is not enough. It is necessary to go beyond Fiscal Federalism and involve other elements, of political and institutional nature. Therefore, the key issue is to formulate a proposal that would identify a method covering all interrelated aspects. Such a proposal has put forward, introducing a method of using a series of criteria that will justify the funding of a policy under the European budget. According to this method there are ten questions to be asked, or more precisely, ten criteria to be met, in order for a policy to be eligible for EU funding.<sup>161</sup> The criteria may be divided as follows: The first group refers to Fiscal Federalism, and includes the achievement of economies of scale, the support to policies with an external dimension (i.e. transport), the homogeneity of the policies' content, and the possibility/risk of political failure. The second group includes political criteria, such as whether the policy falls within the political objectives of the Union, or whether the results of the policy's implementation are visible and important to citizens. The third group includes criteria based on Public Sector Economics, referring to the necessity of the policy (for correcting the operation of the market or ensure social justice), the *per se* necessity of funding instead of other means (i.e. regulation), and the cost-effectiveness of the spending programme, seeking the superiority of its benefits over its costs. Finally the fourth group refers to the legal principles of subsidiarity and proportionality, i.e. on whether the objectives can be better achieved through the funding of the European budget or the national budgets, and on the funding being limited to what is necessary to achieve the objectives. In order to implement this method, the starting point is the preparation of a list of

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<sup>160</sup> I. Begg, *op. cit.*, pp. 21-23.

<sup>161</sup> F. Figueira, A Better Budget for Europe: Economically Efficient, Politically Realistic, SIEPS, European Policy Analysis – Issue 2, 2008, p. 1-4

policies or objectives, upon which all these criteria must be implemented in order to set the funding priorities.<sup>162</sup>

## VIII. Conclusion

It is obvious from the above analysis that reforming the European budget is not an easy task. It calls for interdisciplinary expertise and political will to depart from certain approaches that have dominated the area of Europe's finances so far.

At the moment it seems that the Union cannot decide whether it wants a budget that redistributes money from one set of Member States to another or a budget that supports financially the implementation of certain EU-wide policies.<sup>163</sup> An idea would be to make a drastic change and replace all European budget payments to the Member States with a system of straight cash transfers, calculating, as a starting point, the current level of amounts that each Member State receive from the European budget, under any heading.<sup>164</sup>

Such a solution, although simple and therefore interesting, seems to overlook the parameters identified above, in relation to the various factors influencing the preparation of the budget, in terms of a multi-annual framework. These can be summarised in to concepts: budgetary efficiency and budgetary legitimacy.

The efficiency of a budgetary procedure can be described as the timely and flexible allocation of resources in order to ensure the appropriate provision of the main public goods required. The legitimacy of a budgetary procedure derives from the degree of democratic control by citizens so that resources are allocated according to the will of the people and that any kind of misappropriations is minimised. These two elements are seen by some as conflicting to each other.<sup>165</sup> But in the context of a strong political entity, based on functioning democratic principles, in which the delegation of powers to a strong political authority for efficiency reasons will be embedded in an

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<sup>162</sup> F. Figueira, *op. cit.*, p. 4.

<sup>163</sup> I. Begg, Fr. Heinemann, *op. cit.*, p. 5.

<sup>164</sup> I. Begg, Fr. Heinemann, *op. cit.*, p. 6.

<sup>165</sup> H. Enderlein, J. Lindner, O. Calvo-Gonzalez, R. Ritter, *The EU Budget – How much scope for institutional reform?*, European Central Bank, Occasional Paper Series No 27, April 2005, p. 6.

effective democratic control mechanism, ensuring that voters' legitimacy concerns are met, efficiency and legitimacy may actually provide the solution for the tale of the European Budget's reform. Therefore, in order for the Union to have a properly operating multi-annual budgetary system, it has to resolve other more fundamental issues regarding its existence. The failure of the Constitutional Treaty and the risks associated with the process of ratifying the Lisbon Treaty are indicative of the issues that need to be tackled in order for the Union to be in a position to have a proper European Budget.