The UK and the European Budget:

Conference held on 13th October 2011

Summary

Three differing approaches to the UK and the European budget were offered by the speakers at the first of four conferences. Vasco Cal, a policy adviser to the European Commission (EC), presented a view from Brussels, in which he was optimistic that the 2014-20 Multinational Financial Framework (MFF) would be an improvement upon the current 2007-13 budget structure. He welcomed the Commission's proposal that the future financial framework would be simplified and made more inclusive, with the participation of national parliaments at the proposal stage. Mr Cal added that the Commission believed the modifications to the 2014-20 MFF would meet the rigorous expectations of the EU 2020 growth strategy. The Chairman of the House of Lords EU Sub-Committee A, Economic and Financial Affairs, and International Trade, Lord Harrison, delivered a presentation which rejected the Commission's request to increase the size of the forthcoming EU budget and argued that the seven year budget was too inflexible and in need of reform. The final speaker, Professor Iain Begg of the London School of Economics, set forth a critical analysis of the proposed 2014-20 framework, challenging the notion that the Commission's proposals had reformed the European budget. Professor Begg believed the new proposals were rather a 'repackaging', largely maintaining the status quo of the previous budget frameworks. Professor Begg claimed that the proposed financial framework for 2014-20 was neither innovative nor modernizing, and pointed out that it may well risk rejection, given that eight major member states, including the UK, had already rejected many of its individual proposals.

The view from Brussels

Vasco Cal, economic adviser in the Bureau of European Policy Advisers of the European Commission, claimed that the 2014-20 European budget framework will be significantly simpler than the the 2007-13 framework. The simplification of the budget has been proposed with the intention of clarifying a number of controversial issues, including the complexities of the rebate question. Having played a significant role on the formation of the current financial framework as well as currently advising on policy proposals for the 2014-20 budgetary structure, Mr Cal asserted that there were four fundamental aspects that differentiated the 2014-20 proposals from the current 2007-13 budget framework.

The first facet of difference was the fact that the framework is this time being ‘prepared in more detail with rigorous concentration from all interested parties’. Second, as a consequence of careful scrutiny devoted to the weaker aspects of the 2007-13 framework, numerous reforms of these weaker aspects have been proposed, a point of particular interest to the Commission President Mr Barroso. Third, without underplaying the significance of the global financial crisis beginning in 2008, the 2014-20 framework will prioritise research and development programmes with the intention of stimulating growth, replenishing the stagnant employment market and achieving the goals that the EU has set itself in accordance with its 2020 growth strategy. Finally, the 2014-20 framework takes into coherent account the delicate issue of rebates. For many Member States, including the United Kingdom, the present situation is a highly unsatisfactory one.

Mr Cal said that he had long believed in the necessity of broader consultation on European budgetary issues. This had not always been a popular approach and he quoted one of his colleagues at the time of the adoption of the last financial framework as saying ‘nobody knows about the budget...it is a matter too technical and complex to risk inviting public debate.’ Times however have changed. The Chairman of the European Parliaments Budget Committee Alain Lamassoure recently rightly remarked that ‘a debate of such importance should not be held in the secrecy of ministerial meetings behind closed doors’ but include the participation of national parliaments.

Mr Cal recalled that twenty six out of twenty seven member states have already taken a public stance, either negative or positive, on the 2014-20 proposals, a development which he regards as highly positive. He did however recognize the limits of this consultation, which remained ‘quite uneven because in many policy areas people preferred to participate only in the discussions inside their own areas’. Regions for example were focused almost exclusively on discussions about regional policy. This meant that the confrontation of radically different underlying viewpoints was not always possible. No consistent debate had taken place on questions such as to what extent reforms of the current budget were needed, what areas of policy should be reinforced or discarded and how much the budget should be reliant on demonstrably national contributions. Even so, and contrary to 2005, the European Commission had achieved a significant public debate on the budget and at the same time was able to undertake substantial research into the future financial framework. A range of projects carried out to examine previous expenditure under the European budget, to consider the reform of income generation for the budget and to evaluate the effectiveness of more than 200 European policies had ensured that the Commission was ‘quite well prepared’ in presenting proposals to the member states.

Mr Cal also claimed that there was a degree of cohesion between the different policy areas of the proposed new framework, which was absent in 2005 under the then EC President Romano Prodi. At that time the Commission had proposed an unrealistically ambitious new budgetary framework. In consequence, in 2005 the debate on the new Financial Perspective was dominated by proposals from the Presidency and not by those of the Commission. The current Commission President Jose Manuel Barroso has aimed, according to Mr Cal, to produce a proposal which will not attract easy rejection and will be as close as possible to the final budget framework. When, in July 2011, the Commission presented its proposed financial framework for 2014-20, it was given a notably warmer welcome than occurred in 2005. Admittedly, each member state, had at least one feature of the proposal they wanted to amend. But for Mr Cal, this was an inevitable part of the 'framing of the discussion'.

The Commission's main goal in the new proposed budgetary framework is, according to Mr Cal, to support the goals of the Europe 2020 growth strategy, presenting proposals that are innovative, sustainable and efficient. Mr Cal argued that the current EU budget, made up of just one percent of nation Member States' Gross National Income (GNI) is by no means enough to achieve these goals. The Commission for its part envisages a future budget that will be transformed from a grants-based financial instrument to one in which conditional loans play a much larger role. The Commission hopes that this move will encourage much needed private investment back into the market. The Commission believes that for the EU 'public money will not be enough for all needs of investment that we are facing now in many areas'.

The specific goal of the Commission's new proposed financial initiative ("Connecting Europe Fund") will be to speed up investment projects, especially infrastructure projects that have been halted because of the ongoing economic crisis. This proposal has already faced, however, challenging opposition from several Member States and the Commission has amended its original proposal. The Commission has also raised the possibility of freezing expenditure on the Common Agricultural Policy (CAP) and 'with this nominal freeze ......reinforce research and development policy as well as (introduce) a component on external relations'.

A further contrast to the current budget negotiated in 2005 is the proposal concerning the generation of resources for the European budget. In its draft for the 2014-20 framework the Commission decided to make proposals on the national budget contributions to the European budget because 'we thought the relationship between the national budget contributions and European budget is in a certain way having unintended consequences on the way the policies are managing themselves'. As a consequence, the Commission has proposed, in September 2011, a Financial Concession Tax (FCT), sparking a huge debate within the financial sector. Non

Eurozone governments, including the UK and Sweden, have so far shown reluctance to implement any such tax. Mr Cal reminded his audience that the FCT proposal was based on a proposition made during the G20 meetings in Cannes in 2011.

A second proposal tabled by the Commission for the future financing of the budget was a reform of Value Added Tax (VAT). The Commission has proposed that the EU model itself on the US federal system so that European citizens will in future know how much of this particular tax 'will go to the national budget and how much will go to the supranational European budget'. The intended outcome of these two proposals is that the European budget will be less dependent on national contributions coming directly from national budgets and 'we think we are respecting more closely what the treaty said about the fact that the EU should be financed by our own 'resources'.

The British rebate is, as a result of the 2005 agreement, calculated in a complicated and sometimes confusing way, leading to concerns as to its transparency. As part of the simplification of the future financial framework, the Commission 'decided to go back to basics' and review the decision made in 1984, under the then Prime Minister Margaret Thatcher at Fontainebleau, at a time when Britain was the third poorest member of the European Community. As the rebate no longer applies only to the UK but also to Germany, Holland and Sweden, the Commission, according to Mr Cal, is proposing to 'have the same system for all the countries...and we propose to do it in the simplest way, making calculations about what would be the relevant burden and proposing a lump sum for each year of the budget that corresponds to the compensation of these countries'. Some countries have voiced concern over this system, but Mr Cal insisted that the Commission's calculations about the proposed lump sums were correct.

Mr Cal hoped in conclusion that the Union's decision-making process for the next financial framework will be simplified as a result of the Commission's proposals. History taught however that aspirations for simplification are not always fulfilled in the European Union. They could even lead eventually to further complications in the existing system.

Britain and the budget

Lord Harrison, a former Member of the European Parliament (MEP) for the Labour Party (1989-99), reported on the House of Lords document: '*The EU financial framework from 2014.*' Lord Harrison explained that any budget increase for the European budget of 2012 had already been rejected by the Lords in tandem with the House of Commons. The European Commission had requested a 4.9 percent budget increase, something the UK government declined to accept.

Lord Harrison reviewed the political context that surrounded the British government's rejection of any budget increase. First, the UK is battling to revive its troubled economy and has implemented various unpopular austerity measures. Second, increasing the size of the European budget is a difficult policy to explain to a somewhat sceptical British public, One *ICM Guardian Poll* conducted in October 2011 recorded that 52 percent of the British public agreed that the euro crisis provided the ideal opportunity for Britain to leave the EU altogether.

Lord Harrison said in his address that he personally was not against in the longer term an enlarged European budget. While serving as a Labour MEP, he had found however a substantial amount of ignorance existing in the UK's business community regarding the workings of the EU. According to Lord Harrison, there was for instance widespread unawareness concerning the individuals who held 'key financial positions' in the EU such as Sir Brian Unwin, former President of the European Investment Bank (EIB) and Sir Nigel Wicks, Chairman of the Board of Directors of Euroclear. Lord Harrison regretted that leading members of the British business community were ignorant of 'the very significant positions that these men held and what they could have done if they had a more positive view towards the EU' sustaining them from the United Kingdom.

For Lord Harrison, 'Britain's attitude (towards Europe) has been short-sighted rather than long-sighted'. The reasoning behind the UK's policy towards Europe stems from 'a problem that is associated with politicians and with democracy…. this wretched thing called elections'. The democratic process causes policy to be, in some part, accommodating to popular opinion which in the UK is overwhelmingly sceptical of the EU. It is this factor which requires policy makers 'to adopt short term methods instead of the long term methods that we should be adopting for the benefit of the United Kingdom and European Union'.

According to Lord Harrison, the United Kingdom should not expect to escape unscathed from the economic problems of the Eurozone. In 2011, despite the economic slowdown, Britain alone exported £27.5bn worth of goods to Germany (up 17.2 percent from 2010) and £18.9bn of commodities to France (up 14.3 percent from the previous year). Lord Harrison believed that the current Eurozone crisis, which is an abundant threat to the future survival of the single currency, stems from the model pursued of 'a monetary union...and (which) didn't do a lot towards creating a fiscal union, and which did not help secure the single currency against the crisis that the Eurozone is facing today.' Lord Harrison regretted in retrospect that the European Union's 'obsession with the single market' may have blinded the creators of the single European currency to the need for a fiscal union that would have secured the future of the euro.

In order to establish a fiscal union in addition to the current Europe-wide economic and monetary union would require nation states to surrender elements of sovereignty to a centralised EU. Tax collection and national spending, which are currently responsibilities of national governments, would have to be handed over to the EU 'super-state' if a fiscal union were established.

If this were to occur there is little doubt that in Britain a great deal of hostility and suspicion would arise out of relinquishing 'more' sovereignty to Brussels. Furthermore, Britain does not stand alone in its hostility to a European 'super-state' as a number of other EU states also experience high levels of scepticism, both in public opinion and within relatively large, mainstream political parties. Achieving a fiscal union would require an overhaul of persistent and ever growing 'negative attitudes' towards the EU.

Lord Harrison repeated that he and his colleagues in the House of Lords rejected increasing the overall input of nation states into the budget, but stressed that they had also recommended in their recent report ways in which the budget could be better structured. As a first step, Lord Harrison suggested that the seven year time frame of the European budget could be reduced to five years. Certainly economic policy planned around austerity may well dominate the next two years, but should economic conditions in the EU 'brighten' after that period the budget framework may need reassessment.

Central to the new financial framework is the issue of the Common Agricultural Policy (CAP). Lord Harrison remarked that it is 'no longer defensible' to spend such a high amount, currently standing at 44 percent of the EU budget, for a sector employing just 4 percent of Europe's working population. Allocated funds should be reduced and invested into research and development, overseas aid and the modernization of failing European economies.

In the matter of the proposed Financial Transactions Tax (FTT) and its possible use in helping finance the EU Budget, Lord Harrison reported that the House of Lords Select Committee will be examining this issue in general terms, while his own Sub Committee will examine the merits of using the FTT to curb rogue trading on the financial markets.

In summing up, Lord Harrison echoed a point put by Brendan Donnelly on the issue of the EU budget earlier in the year when he spoke to Lord Harrison's Sub-Committee. At that hearing Mr Donnelly had argued that the European budget was neither 'too big nor too small'. It was not well adjusted to the expectations vested in it, but whether these expectations required more or less money varied from sector to sector. Lord Harrison explained that he favoured in present

circumstances 'a zero based budgeting exercise' for the Union's budget. He, Lord Harrison, thought that member states of the Union should act together to diminish 'negative attitudes' towards greater European unity. Additionally, finding a solution to the current euro crisis was fundamental to achieving the restoration of economic growth and thus the credibility of Europe as a whole.

A 'repackaged' budget?

Professor Iain Begg, from the London School of Economics and Political Science, opened his address by reflecting on the current economic context which has led a large number of member states to implement sever austerity measures. Professor Begg argued in particular that the current financial crisis has resulted in a number of specific problems in relation to the 2014-20 Budget framework. The number of member states 'all shouting for austerity' has caused the policy of austerity to 'dominate everything' including ongoing negotiations surrounding the future budget. But the applicability of arguments about austerity to a financial framework designed to last until 2020 can only be limited. 'If austerity is not a fading memory by then, than we are in far deeper trouble than we all understand'. The current discussions about the 2014-20 budgetary framework should not simply focus on the coming two or three years.

In Professor Begg's view, the ongoing budget talks have left the British Coalition government in a 'horrible position'. The UK has been active in producing numerous demands for the reform of the budget. The Commission however has stated that budgetary items such as the funding for the Common Agricultural Policy (CAP) should remain at the levels of the current 2007-13 framework. At the same time the Commission wants more investment on research and other similar initiatives, an approach about which Professor Begg harbours considerable doubts. Anyone reading the Commission's proposals for the new financial framework would be struck by the constant references, 'running through' the document, to 'EU added value'. But Professor Begg finds this an elusive concept, capable of many overlapping definitions. These definitional difficulties may make it difficult to assess any genuine difference to economic outcomes which the Commission's proposals may facilitate.

Professor Begg commented on Vasco Cal's claim in his earlier contribution that there has been a notable effort by the Commission to simplify the 2014-20 budget framework in comparison to the 2007-14 experience. He asked the rhetorical question 'Does anyone ever admit to having produced a deliberately complicated document?' Professor Begg also cast doubt upon the Commission's argument that the simplification of the budget will make it more ambitious and enable it to achieve increased funding from member states. The Commission's proposals cannot

in any sense be regarded as ambitious. The 1 or 1.1 percent of EU GDP that the Commission is likely to receive under the new financial framework 'is the small change of the public finance'. Most member states typically devote 40 or 50 percent of the nation's GDP to public expenditure.

It is moreover far from clear for Professor Begg how the Commission's proposals will promote the Union's goals contained in the EU 2020 growth strategy. The notion of conditionality is a particularly 'vexed issue' for him. 'Conditionality' has been put forward by the Commission as a technique to encourage the carrying out of infrastructure programmes. But the potential recipients of European funding may not be able to guarantee the most important conditionality of all, that of macro-economic policy in the member state or region concerned. The Commission seems to believe that the greater centralization of macro-economic policy implicit in the current reforms of the Eurozone will resolve this potential problem. Professor Begg doubted however that central decision-makers, whether in Brussels or national capitals, will be as sympathetic as the Commission supposes to the specific problems of regional politicians and officials attempting to gain conditional European funding.

Professor Begg welcomed one of the new funding plans proposed by the Commission, namely the Connecting Europe Fund. The Fund would involve 50bn euros invested by the EU, in accordance with the Europe 2020 strategy, to develop 'roads, railways, energy grids, pipelines and high-speed broadband networks'. Professor Begg agreed that this was a 'logical' proposal and that there is a definite need for such a supra-national fund. But he pointed out that a number of member states (including the UK) and regional bodies have criticized the proposal as excessively centralising.

Professor Begg also echoed the view expressed earlier in the conference by Lord Harrison that the 44 percent of the budget effectively allocated to the CAP is incompatible with the budget's supposed commitment to 'sustainable growth'. The Commission admittedly claimed that the money allocated to the CAP in the new financial framework was in reality less than 44 percent of the total, Professor Begg regarded this claim as simple 'repackaging'. His argument was that money spent on the CAP's rural development fund between 2007 and 2013 will continue to be devoted to the CAP under the new label of 'sustainability'. Similar blurring of categories could be seen in the attribution of what was previously labelled 'cohesion policy' to the Europe 2020 budget heading. Professor Begg's overall judgement was that 'many of the same things are in the budget.….a lot of repackaging has gone into it and .....the core weakness of the proposal is a large component of the status quo and a very small component of genuine innovation'.

Nor was Professor Begg greatly impressed with the Commission's new proposals, mainly through new taxation initiatives, to improve the Union's funding. He questioned how realistic such initiatives were, given that the power to tax is a jealously guarded national prerogative. Any moves towards an EU federal tax system along American lines would imply a radical transformation of existing attitudes. Professor Begg agreed with Mr Cal's earlier remark that the existing VAT resource of funding for the Union 'has slowly changed into a de facto national contribution'. But he could not see any improvement to this situation arising from the Commission's further proposal 'to replace the VAT resource with a VAT resource'. Even if the Commission's proposal were to be successful and an EU component of VAT taxation were introduced, many prices across the EU would increase in consequence. Moreover, the application of VAT varies from member state to member state. In France, the Commission's proposal would presumably lead to an increase in the price of children's clothing, already subject to VAT. In Britain it would, paradoxically, have no comparable effect since in the UK children's clothes are not subject to VAT.

Professor Begg also saw difficulties in the Commission's proposal to raise EU revenue by a Financial Transaction Tax (FTT). The volume of often automated financial transactions in Europe, and more particularly in the City of London, made this proposal in many ways an attractive one, but if any concerted attempt is made to tax financial transactions, the EU and especially the City of London may simply lose business, thus diminishing the global economic position of the EU as businesses may seek to establish themselves in other countries with a more favourable taxation policy. For an FTT to be successful, moreover, Professor Begg saw it as being essential to ensure that 'all financial transactions would be caught' by the tax, in his view a very implausible assumption. There were also, to Professor Begg's mind, philosophical difficulties inherent in taxing transactions rather than taxing the production of added value. All these considerations led Professor Begg to doubt the appropriateness of FTT as an EU tax, even if the problem could be overcome of gaining acceptance for it in public and political opinion.

In conclusion, Professor Begg made three general points. First, in his view the budget proposals of the Commission for 2014-20 are too cautious and lack innovation. Second, they are unlikely to be adopted, following the 'quick rejection' from five major net payers (the UK, Austria, Netherlands, Germany and Sweden). These countries have already received support from France, Finland and Italy, who are demanding 100bn euros be slashed from the European budget. Finally the political context of the continuing budget negotiations should not be ignored. Until the end of last year Poland held the Presidency of the Council and it was reluctant, as a major benefactor of the budget, to see its restructuring. The current Danish presidency has

proved similarly hesitant and it seems likely that the task of renegotiating the budget will now fall to the Presidency of Cyprus, beginning in July 2012. Professor Begg questioned whether Cyprus, a relatively small and young country in the EU with limited experience of its workings, would be able to deal with this challenging issue. It might be that the European Commission was hoping that the Cypriot Presidency would be dependent upon the assistance of the Commission to structure the budgetary discussion in late 2012. This dependence might in its turn enable the Commission to press the Cypriot Presidency towards Mr. Barroso's agenda for the (non-) reform of the European budget. Those who lived longest would know most.