Germany's financial linkage to the EU budget

Medium-term planning for financing the European Union between 2007 and 2013 is to be finalised by 2006. However, the situation has been changing significantly, not least because the economic strength of the majority of the recently acceded countries is far below average.

The financial planning involves decisions on the level and structure of future expenditure and on the rules governing how this expenditure is to be financed. Each country's net contribution ultimately depends on the financing rules and the expenditure agreed. Germany makes the largest financial contribution to the EU budget in absolute terms. This amounted to €8½ billion in 2004. Particularly as a result of the insignificance of agriculture in Germany relative to the EU average, Germany is also one of the major net financiers of the EU budget in terms of its economic performance as well.

This article examines Germany's financial linkage to the EU budget. It starts by providing a brief overview of EU financial developments during the past few years and the plans for this year and next before discussing the European Commission's proposals for the medium-term planning of EU financing up to 2013.

EU budget expenditure and receipts

Net position is result of receipts and expenditure policy

How the EU's political objectives are financed at Community level is reflected in the EU budget. On the expenditure side the agricultural subsidies and the assistance payments to the economically weaker regions predominate. On the receipts side the amount which individual member states contribute towards the financing of the budget is laid down, the amount levied being largely in line with the corresponding national economic strength. A country's net payer position is ultimately derived from the decision taken on receipts and expenditure.

EU expenditure

Expenditure ceiling regularly undershot

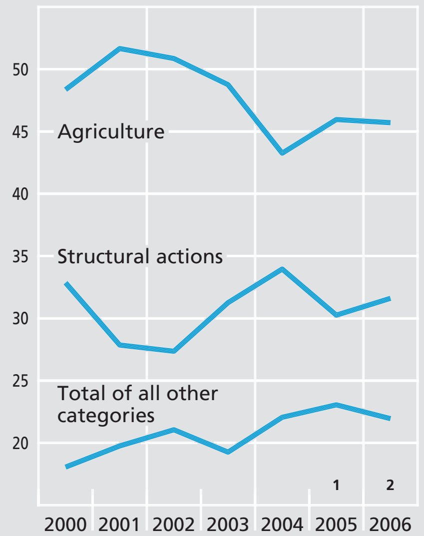
The annual ceiling for EU budget expenditure (payment appropriations) is currently 1.24% of the gross national income (GNI) of all member states. The member states' financial contributions can be set and collected only up to this amount. In 2004 the total sum actually spent amounted to €100.1 billion, which was 0.98% of GNI, as in previous years, and therefore significantly less than the annual ceiling (see the table on page 17). While this represents a 10½% increase in expenditure compared with that of 2003, most of the increase was due to the EU enlargement on 1 May 2004. Almost 7½ percentage points of the growth of nearly 12% of the allocatable expenditure burden shared by the individual member states were due to the new member states.[1]

Expenditure may be subdivided into three main categories. Agriculture, despite a significant reduction from just over 49% in 2003 to 43½% in 2004, continued to account for the largest share of total EU expenditure (€43.6 billion in 2004 compared with €44.4 billion in 2003). Rising expenditures on structural actions were also significant (just over 34%, or €34.2 billion compared with €28.5 billion a year earlier). Of the structural actions included in the budget only €0.2 billion was not taken up in 2004. In previous years the discrepancy was much greater, with the result that the budgetary commitments up to the end of the planning period (2000 to 2006) are considerable. Consequently, the funds initially budgeted for these areas might be exceeded in 2005 and 2006 because the extent

Agricultural expenditure still largest component

EU expenditure by policy area

as a percentage of total expenditure



Source: Report by the European Commission on the allocation of EU expenditure by member state in 2004. — **1** Including supplementary budgets and correction budgets. — **2** Total 2006 draft budget.

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1 For the statistics see European Commission, Allocation of 2004 EU expenditure by Member State, September 2005.

Total EU expenditure and receipts

€ billion unless shown as a percentage

Item	1999	2000	2001	2002	2003	2004	2005 1	2006 2
Expenditure								
Agriculture	39.8	40.5	41.5	43.5	44.4	43.6	49.1	51.2
Structural actions	26.7	27.6	22.5	23.5	28.5	34.2	32.4	35.5
Internal policies	4.5	5.4	5.3	6.6	5.7	7.3	7.9	8.3
External actions	4.6	3.8	4.2	4.4	4.3	4.6	5.5	5.3
Reserves	0.3	0.2	0.2	0.2	0.1	0.2	0.4	0.5
Pre-accession strategy 3	–	1.2	1.4	1.8	2.2	4.5	4.6	4.1
Administration	4.5	4.6	4.9	5.2	5.3	5.9	6.3	6.6
Total	80.3	83.3	80.0	85.1	90.6	100.1	106.2	111.4
Percentage change from previous year	– 0.5	3.8	– 4.0	6.4	6.4	10.6	6.1	4.9
Memo item: percentage of GNI	1.00	0.98	0.91	0.93	0.98	0.98	1.00	1.01
Receipts								
Traditional own resources 4	13.9	15.3	14.6	9.2	10.9	12.3	12.4	14.2
VAT-based own resource	31.3	35.2	31.3	22.4	21.3	13.9	15.3	15.9
GNI-based own resource	37.5	37.6	34.9	45.9	51.2	69.0	77.6	81.2
Other receipts 5	4.2	4.7	13.5	17.9	10.1	8.3	1.0	1.3
Total	86.9	92.7	94.3	95.4	93.5	103.5	106.3	112.6
Percentage change from previous year	2.8	6.7	1.7	1.2	– 2.1	10.7	2.7	5.9
Balance for the financial year	6.6	9.4	14.3	10.3	2.9	3.4	0.1	1.1

Source: European Commission and Bundesbank calculations. — **1** Budget (funds for payments) for the EU 25. — **2** Draft budget (version following the first reading in the European Council in July 2005). — **3** Including compensatory payments for new member states. — **4** Net, ie less the refund paid to member states for collection expenses. In the financial year 2002 the lump-sum refund paid to member states for this purpose was raised from 10% to 25% of the amount member states contributed to the EU. — **5** Including residual surpluses from the previous financial year.

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of the projects introduced has now been increased. Just over 7% was spent on the "internal policies" – such as education, energy and environment or even trans-European networks. Pre-accession aid for the new member states accounted for 4½%.

Funds returning to Germany stable

In 2004 Germany accounted for just over €11½ billion, or 11½%, of the EU's expenditure. This means that there was virtually no change in the share from the previous year. Just over €6 billion went into the agricultural sector while approximately €4½ billion was used for structural actions. The European Regional Development Fund (ERDF) accounted for just over half of this. Nearly one-third came from the European Social Fund (ESF). The bulk of the structural funds (almost 70%) was paid out under the "Objective 1" measures in which the federal states in eastern Germany participate.[2]

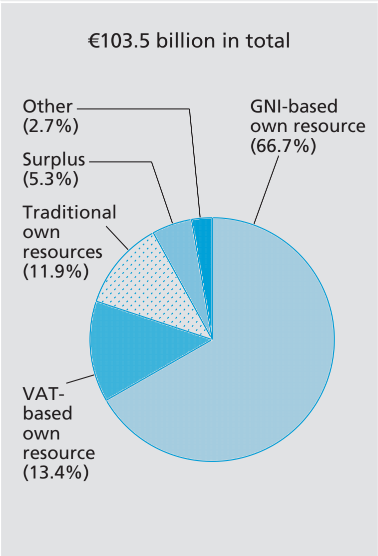
Financing

National financing contributions geared to GNI

The EU's expenditure is largely covered by its own resources. These include traditional own resources which consist primarily of customs duties (2004: just under 12% of total income), value-added tax based own resource, which is collected from the member states on the basis of a harmonised assessment base (13½%), and GNI based own resources (just

2 Objective 1 areas of the structural aid are regions in which per capita GDP (in purchasing power standards) is less than 75% of the Community average.

Total EU receipts in 2004



Source: Report by the European Commission on the allocation of EU expenditure by member state in 2004.

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over 66½%).[3] While the transfer rate for funds stemming from VAT is fixed, the corresponding rate for GNI-based contributions is not determined until the EU's residual financing needs have been ascertained after all the planning has been done and any remaining income has been deducted.[4] Financing the EU budget through borrowing is legally forbidden. Planned receipts and expenditure must be completely matched. Any surplus is to be shown on the receipts side in the following financial year. Any unforeseen expenditure requires an amendment to the budget.

United Kingdom benefits from special regulation

The United Kingdom receives a refund of 66% of its actual net contribution (excluding traditional own resources) as a result of an agreement which was concluded in 1985 following a European Council meeting held in Fontainebleau in 1984 (and which has been slightly modified over time). The contribution made by the other member states to finance this correction is again based on their national GNI. Since 2001 Germany, the Netherlands, Austria and Sweden have been paying only 25% of the resultant correction contributions with all other member states paying a correspondingly larger amount.[5] In absolute terms the correction in 2004 meant just over €5 billion in financial relief to the United Kingdom.

Germany makes major contribution to financing EU budget

Germany paid just over €20 billion to the EU in 2004. Only just over 2½ billion of this was in the form of VAT-based own resource while GNI-based own resource made up the bulk of its contribution at almost €15 billion. These two items were the equivalent of 8% of the German government's tax revenue, from which the amounts concerned were paid. In absolute terms, Germany's contribution has fluctuated sharply in the past few years. By contrast, its share of the EU's total receipts has continually declined – primarily as a result of the gradual decrease in Germany's total economic weight within the EU. For example, Germany's share of total own resource payments fell from 31½% in 1995 to 23% in

3 The reduction in VAT-based own resource and the simultaneous increase in GNI-based own resource that have occurred since 2002 are the result of an agreement reached by the European Council in March 1999 (Agenda 2000). This initially lowered the maximum levy rate for VAT-based own resource from 1.0% to 0.75% (2002 and 2003) and then from 2004 to 0.5% of the harmonised VAT assessment base.
4 The national contribution of each of the ten new member states was based on only two-thirds of their GNI in 2004 as their accession took place on 1 May 2004.
5 Previously, Germany alone had been relieved of one-third of its actual payments under the correction agreement in favour of the United Kingdom.

2003 and to just under 21½% last year. In the same period the German share of all EU countries' GNI declined from just under 28½% to approximately 22% and finally in 2004, primarily as a result of EU enlargement, to just under 21½%.

Net contribution

Net contribution as indicator of financial burden or relief

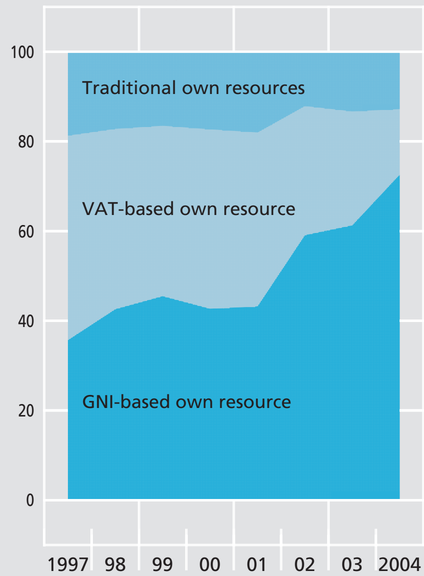
A country's net position indicates the financial advantage or disadvantage which it has vis-à-vis the EU budget. It is defined as the difference between a country's financial contributions to the EU and the amount of funds that country receives from the EU. Inaccuracies arise here because not only some of the receipts (such as customs duties) but also various types of expenditure (such as expenditure on administration) cannot be attributed to specific member states with any certainty.[6] The EU also makes payments within the framework of its external actions which do not accrue to EU member states and therefore do not represent allocatable expenditure. Nonetheless, the net contribution is an informative factor which plays an important role, especially in the political debate.

Germany largest net payer in absolute terms

In 2004 Germany's net contribution amounted to approximately €8½ billion after all allocatable payments had been taken into consideration. In absolute terms, Germany is therefore the largest net contributor to the EU. If expenditure on administration – which is of little importance in the case of Germany – and traditional own resources are disregarded, however, Germany's contribution amounted to €6 billion.[7] On this basis Germany was the fourth-largest net financial contributor in 2004, with a contribution of 0.3% of its GNI. The Netherlands (0.4%), Luxembourg (just under 0.4%) and Sweden (just over 0.3%) paid even larger contributions (see the explanatory notes on pp 20-21).

Breakdown of EU's own resources

as a percentage of total own resources



Source: Report by the European Commission on the allocation of EU expenditure by member state in 2004.

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Financial effects of EU enlargement in 2004 moderate

The accession of the ten new member states on 1 May 2004 was taken into account when the EU budget for 2004 was being drawn up.

6 For the informative value of net contributions see Deutsche Bundesbank, Recent developments in Germany's financial relations with the European Union, *Monthly Report*, July 1999, p 65.
7 These figures deviate from those of the European Commission. The Commission regularly publishes operational budgetary balances which likewise eliminate expenditure on administration and the traditional own resources from its calculations. In addition, however, the remaining financing contributions of the individual countries are extrapolated in such a way that they match the total operational expenditure considered in the calculation. Consequently, the net contributions are larger using this method. The figure for Germany in 2004 is just over 7 billion.

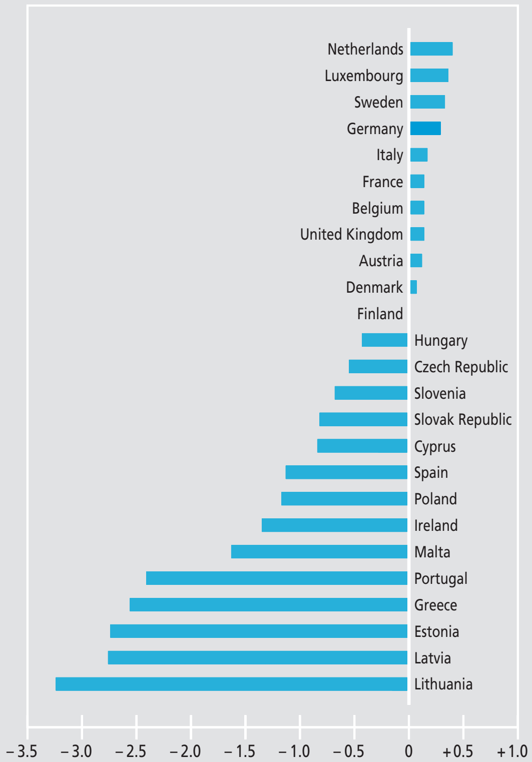
Analysis of national net contributions to the EU budget

In 2004, Germany paid just over 0.9% of its gross national income (GNI) into the EU budget, whereas it received just over 0.5% back. The resultant net contribution amounted to 0.4% of GNI. However, the informative value of these figures should be put in perspective. For example, particularly the traditional own resources (mainly customs duties) are regarded primarily as EU revenue. In addition, they are concentrated on a few countries with major ports, especially the Netherlands and Belgium ("Antwerp-Rotterdam effect"). In respect of administrative expenditure, the concentration is even heavier in Belgium and Luxembourg. This expenditure essentially covers remuneration for the services of those (of various nationalities) working there.

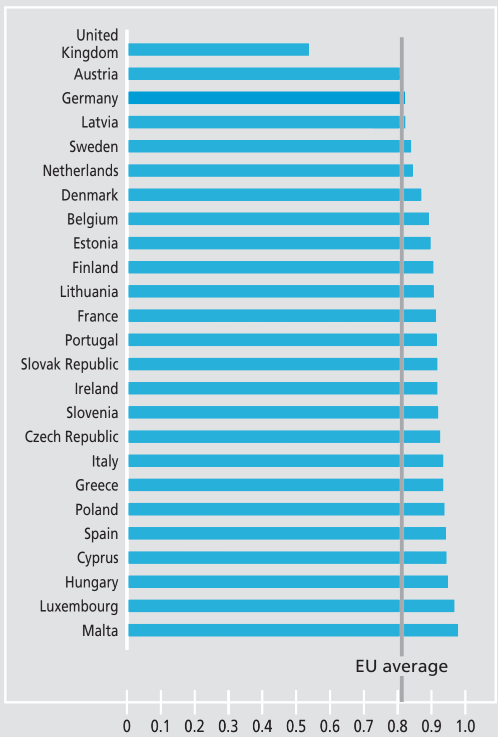
If, on the receipts side, the traditional own resources and, on the expenditure side, the cost of administration are not distributed among the individual member states, there will be a net transfer of resources amounting to 0.3% of GNI in the case of Germany to the EU budget, 0.8% of which are contributions and just over 0.5% of GNI is money returned. This means that, in terms of economic strength, Germany was the fourth-largest net financier of the EU budget after the Netherlands, Luxembourg and Sweden. The largest net recipients, on the other hand, were the Baltic states of Lithuania, Latvia and Estonia as well as Greece and Portugal.[2]

Germany's large net contribution is not a result of disproportionately large transfers of its own resources

Net contribution
as a percentage of national GNI[1]



VAT-based own resources and
GNI-based own resources
as a percentage of national GNI[3]



1 Excluding traditional own resources and excluding administrative expenditure. — **2** As the ten new member states did not join the EU until 1 May 2004, only two-thirds of each member state's GNI was used in the EU budget as a basis for determinig the amounts of VAT-based

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paid over to the EU budget. Despite its slightly above-average prosperity since EU enlargement, Germany transfers only average levels of VAT-based own resources and GNI-based own resources to the EU. The reason for Germany's relatively low level of transfers to the EU is that Germany, together with the Netherlands, Sweden and Austria, pays only one-quarter of its normally payable contribution to finance the "British rebate". Only Austria and the United Kingdom are not as heavily burdened, relatively speaking, by financing the EU budget with their own resources.

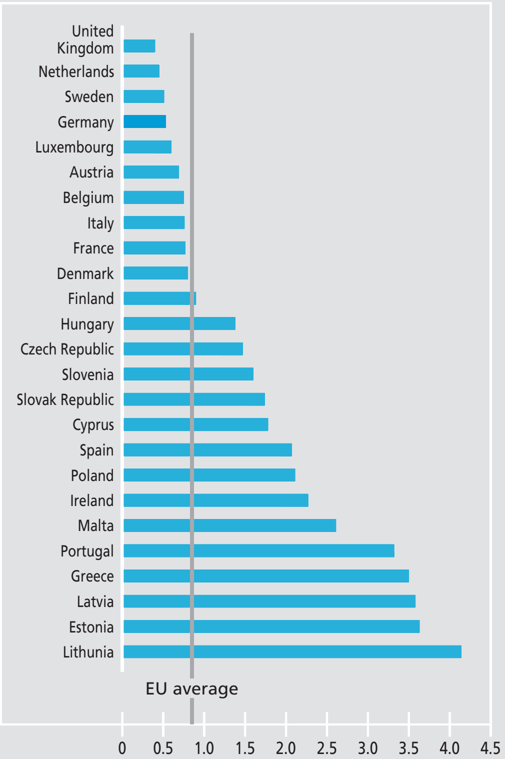
However, disproportionately little of the EU budget is spent on Germany. Only the United Kingdom, the Netherlands and Sweden receive even less funding as a percentage of GNI. By far the biggest recipients of EU funds, however, are the Baltic states as well as Greece and Portugal. It appears that the expenditure side determines the respective net payer position, whereas EU budget revenue is raised largely proportionally to national wealth in terms of GNI.

A further breakdown of the expenditure side illustrates clear differences. For example, of the old member states, the (in relative terms) largest recipients of agricultural subsidies and structural funds are still Greece, Portugal, Ireland and Spain. Ireland received 1.5% of its GNI in the form of agricultural subsidies in 2004 – surpassed only by Greece as the largest recipient. Even though Ireland is now one of the most prosperous of the EU member states in terms of GNI, it still receives far greater than the average amount of structural funds, albeit considerably less than the three southern European countries.

The advantageous net payer position of the new member states in 2004 is not so much a result of the traditional areas of EU budget expenditure but of the pre-accession bridging aid granted to the accession countries (almost 1.1% of the reduced GNI of the ten accession countries).

Given the fact that the operating expenditure returned to Germany amounts to just over 0.5% of its GNI, Germany ranks significantly below the EU average (almost 0.9%). This applies not only to the relatively insignificant expenditure on internal policies but also to both agricultural expenditure (just under 0.3%, compared with an average of just over 0.4%) and the structural assistance provided primarily to eastern Germany (0.2%, compared with just over 0.3%). As a result of EU enlargement, these disparities are likely to continue to widen. Taking into account the transitional arrangements in the area of agriculture, an increasing proportion of the funds earmarked for this will be granted to the new member states. Furthermore, east German regions receiving funds will probably "suffer" from their relative closeness to the aid limit of 75% of GDP per inhabitant. However, this is a reflection of their relative prosperity, compared with many regions in the accession countries.

Operating expenditure
as a percentage of GNI 4



own resources and GNI-based own resources that they had to contribute. By analogy, only two-thirds of the new member states' GNI is taken into account here. — **3** Including adjustment in favour of the United Kingdom. — **4** Excluding administrative expenditure.

The own resources paid over to the EU increased by a total of just over 13½% while total receipts, mainly as a result of the lower surpluses in the previous year, increased at the slower rate of just over 10½%. Overal expenditure also increased by more than 10½%. On the one hand, the new members are achieving a below-average economic performance. In addition, their contributions to the budget have been assessed on the basis of only two-thirds of their GNI. Hence, they have contributed only just over one-fourth to the growth of EU member states' contributions. On the other hand, considerably greater weight is attached to the agriculture sector in the new member countries. However, the increase in expenditure resulting from enlargement was considerably restricted by virtue of an agreement on transition regulations. For example, a ceiling of €22 billion was set for structural aid to the new member states for the years between 2004 and 2006. Moreover, the farmers there received just 25% of the usual direct payments in the first year (30% in 2005). The full amount of financial support will not be paid until the end of a transitional period of ten years. These measures meant that net transfers to the new member states in 2004 were limited to a total of approximately €3 billion.

EU budget in 2005 and 2006

Budget plan will probably be exceeded in current year

The budget plan for the current year provides for expenditure of €106.2 billion, which, according to the plans, is equal to 1.00% of the EU 25 GNI. Given an increase in total expenditure of just over 6%, expenditure on agriculture and rural development is to be 12½% more than in last year's budget. This is due not only to the increase in direct assistance for the new member states but also to the effects of the reform of the Common Agricultural Policy, according to which there is to be a particularly sharp rise in the funds available for developing the countryside. In the draft of the overall budget plan for the coming year[8] a further rise in expenditure on agriculture of almost 4½% to €51.2 billion out of a total expenditure volume of €111.4 billion is planned. The funds allowed for structural actions in the 2005 budget plan were just under 5½% below those in the previous year. As a result of the possible increase in the funds used under the existing budgetary commitments, however, the payments initially scheduled could be exceeded. In contrast to the plan for 2005, expenditure for structural actions are again to be raised by 9½% to €35.5 billion in 2006.

Increase in German financing contribution

An increase in Germany's contributions to the EU is to be expected in 2005. In the federal budget for 2005 payments of more than €22 billion are earmarked (compared with a sum of just over €20 billion which was paid over in 2004). Twice in the current year, however, the Commission has revised member state payments downwards. Particularly as a result of the expected lower rate of growth for Germany and the – albeit relatively small – budget surplus last year, the contributions to be made by Germany will probably remain slightly below the level estimated in the federal budget.

8 Position after the first reading in the Council in July 2005.

Planning for the years 2007 to 2013

Commission proposal on medium-term financial planning ...

How Germany's financial linkage to the EU budget continues to develop will depend essentially on the decision taken on the new financial perspective for 2007 to 2013.[9] The European Commission issued a proposal on this last year, which was based on the assumption that the EU would be further enlarged to 27 member states by the accession of Bulgaria and Romania on 1 January 2007. This proposal continues to be the basis for the negotiations on the financial perspective because during the negotiation rounds that took place under the Luxembourg presidency the European Council was unable to reach an agreement on the compromise solutions that had been proposed. Further negotiations on the financial perspective are expected to take place in December at the earliest under the British presidency or else under the Austrian presidency, which begins in January.

... envisages significant increase in expenditure

Although the European Commission proposes that the payment appropriations which have to be met from the member states' contributions must not exceed the current ceiling of 1.24% of GNI in any one year, it is likely that they will come much closer to the ceiling than they have done in previous years. The plan is for average annual expenditure of 1.14% of GNI. This means that the annual outgoings proposed by the commission will be far above the out-turns and plans up to 2006 (2004: 0.98%, 2005: 1.00% and 2006: 1.01%). This would mean that Germany, in line with its economic size, would have to pay about €3 billion per year more in contributions to the EU budget than it did in 2005.

Internal policies and external actions continue to play a minor role

Expenditure on internal policies (citizenship of the union) and external actions (EU as a global partner) are to rise between 2007 and 2013 by an annual average of almost 8½% or just under 4½% respectively. This would entail a rise of just under 2% to almost 3% in the money spent under the heading "Citizenship" (immigration policy, cooperation with the police and the judicial system, consumer protection and cultural promotion).[10] The planned increase in expenditure share under the heading "Europe as a global partner", namely from 8½% to almost 10%, is a reflection of the efforts to intensify the Common Foreign and Security Policy. From a financial point of view, however, these headings are of minor importance compared with the earmarked expenditure for agriculture and structural actions.

Common agricultural policy

Proportionally smaller future expenditure on CAP

In the new financial forecasts, expenditure on the common agricultural policy (CAP), which still absorbs the lion's share of the EU budget, is to form the largest section under the new heading "Conservation and management of natural resources". In real terms, expenditure on CAP is to remain more or less unchanged

9 The financial perspective is a multiannual financial framework for EU expenditure. It is therefore of a binding nature in that the expenditure ceilings for the individual headings are to be observed. The financial perspective is unanimously agreed by the European Parliament, the Council and the Commission ("Interinstitutional Agreement"). Detailed budgetary plans are to be approved for each of the years in question.
10 The change in the wording of the heading means that in future the most important internal policies such as transport, environment, infrastructure, energy or industry appear under heading 1 (Sustainable growth) and heading 2 (Conservation and management of natural resources). Expenditure in these fields is increasing dramatically.

Financial perspective for the EU budget, 2007 to 2013

2004 prices

	2006 1	2007	2008	2009	2010	2011	2012	2013	Total
	€ billion								
Sustainable development	46.6	58.7	61.9	64.9	67.4	69.8	72.9	76.0	471.5
Conservation and management of natural resources	56.0	57.2	57.9	58.1	58.0	57.9	57.8	57.8	404.7
Citizenship of the European Union	2.3	2.6	2.9	3.2	3.5	3.8	4.1	4.5	24.7
Europe as a global partner 2	11.2	11.3	12.1	12.9	13.7	14.5	15.1	15.7	95.4
Administration 3	3.4	3.7	3.8	4.0	4.1	4.2	4.4	4.5	28.6
Compensation 4	1.0	0.1	0.1	0.1	–	–	–	–	0.2
Total commitment appropriations	120.7	133.6	138.7	143.1	146.7	150.2	154.3	158.5	1,025.0
Total payment appropriations	114.7	124.6	136.5	127.7	126.0	132.4	138.4	143.1	928.7
	as a percentage of GNI								
Commitment appropriations	1.15	1.23	1.25	1.26	1.26	1.26	1.27	1.27	1.26
Payment appropriations	1.09	1.15	1.23	1.12	1.08	1.11	1.14	1.15	1.14
Margin	0.15	0.09	0.01	0.12	0.16	0.13	0.10	0.09	0.10
Own resources ceiling	1.24	1.24	1.24	1.24	1.24	1.24	1.24	1.24	1.24

Source: European Commission, Proposal for renewal of the interinstitutional agreement on budgetary discipline and improvement of the budgetary procedure, COM (2004) 498 final, Brussels, 14 July 2004. — **1** Expenditure for 2006 in accordance with the current 2000-06 financial perspective broken down for comparison in accordance with the new expenditure structure. — **2** It is planned to integrate the European Development Fund into the EU budget in 2008. — **3** Excluding the European Commission's administrative expenditure, which is covered by the first four expenditure items. — **4** Amounts provided for in the European Union's common position with a view to the Accession Conference with Bulgaria (CONF-BG-27/04).

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although the direct payments to farmers in the new member states that are unrelated to output are to rise continually over the coming years. This means that from 2007 the budgeted share of expenditure on the agricultural sector would decline to less than the share of funds spent on general structural actions, which is to be extended significantly.

CAP reform

This downturn in expenditure is based on the Luxembourg resolutions on the reform of the common agricultural policy of June 2003. The key element of this is the decoupling of direct payments from production. Direct payments for, say, the production of arable crops, beef and milk are no longer linked to production or to the number of animals but, instead, are included in a "single farm payment". However, this decoupling is not complete, and the member states still have certain options in implementing the reform.

Linkage of subsidies to standards

Another element of the reform is the linking of direct payments to the observance of additional specifications ("cross-compliance"). The subsidy is paid only if the farmer maintains certain minimum standards with respect to environmental protection, food and fodder safety standards, animal health and welfare and observes the provisions on "good agricultural practice" and ecological conditions. The purpose of the strengthened rural development policy[11] (pillar 2) under the reformed CAP is to help to achieve these objectives.

11 The (new) rural development policy was excluded, by virtue of the commission's proposal on the financial perspective, from the "structural actions" and allocated to agriculture.

Furthermore, provision has been made to redirect funds from the areas of market policy and direct payments (pillar 1) to rural development (modulation).

Distortions remain

The accentuated market orientation which is enshrined in the Luxembourg resolutions and which is to be achieved by changing over to direct payments that are not linked to production and by reducing intervention prices could help to weaken the misguided incentives to deploy excessive resources but without actually removing them.[12] However, more radical measures would be appropriate within the framework of a comprehensive reduction in subsidies even if international competition is distorted by the subsidies of other countries. A more open approach to the world market would make it easier, not least for less developed countries, to gain market access for their agricultural produce.

Subsidy reduction advantageous for Germany

Consequently, the expenditure which has been shifted to the European level should not be overlooked during the current debate in Germany on the desirability of reducing subsidies, especially as Germany, as the largest contributor to the EU budget, helps to finance to a considerable degree the sizeable agricultural expenditure in other countries, including some of the more prosperous. It is true that with respect to repayments Germany, with repayments of just over €6 billion in 2004, was in third place among the recipient countries – in absolute terms – after France (€9.4 billion) and Spain (€6.3 billion). In terms of national GNI (0.28%), however, only two of the other "old" member states, namely the United Kingdom (0.23%) and Luxembourg (0.17%), received even less with regard to repaid contribution amounts.[13]

Structural policy

Importance of structural policy increases significantly

While agricultural expenditure is expected to stagnate in real terms up to 2013, the funds earmarked for general structural actions (to be known as "sustainable growth" in future) will increase sharply. Its share of the budget is to grow from 38½% in 2006 to 48%. The funds planned for the subsection "competitiveness for growth and employment" (notably education and research promotion, and trans-European networks) are to be increased threefold compared with the amount allocated in 2006, a decision which will be seen not least in connection with the Lisbon strategy. That would mean a rise in proportion to the EU GNI from 0.08% to 0.21%. In the subsection "Cohesion for growth and employment" (formerly "Structure and cohesion fund") 32½% more is to be spent in the coming planning period, according to the commission, than at the end of the current planning period (2006), and the corresponding share of the EU GNI is to rise from 0.36% in 2006 to 0.40% by 2013. The considerable increase in the funds for the structural policy is due mainly to the increasing integration of the ten new member states and the expected accession of Bulgaria and Romania during the

12 See OECD, Analysis of the 2003 CAP Reform, Paris 2004.
13 The funds which are spent on agriculture and which accrue to the member states that joined the EU in May 2004 are, in terms of GNI, still below the share paid to Germany except in the case of Latvia and Lithuania. This is due to the transitional provisions, which stipulate that the financial transfers vis-à-vis agriculture will be gradually increased to the full amount over a period of ten years.

planning period, which will mean an accentuation of the economic heterogeneity of the member states.

Enlargement raises number of Objective 1 development regions

EU enlargement has meant a discernible decline in the average per capita GNI. Even so, if the existing assistance criteria – especially the regional per capita GNI of less than 75% of the EU average – are applied, few of the present development regions will have to forgo payments from the structural fund. Only a relatively small number will probably exceed the 75% threshold on statistical grounds alone. However, regions in Spain and eastern Germany, in particular, could be affected.[14] Owing to EU enlargement, the total number of Objective 1 areas has risen significantly. Moreover, transitional regulations are planned which, on the one hand, restrict the level of subsidies to be paid to the recently acceded countries on the grounds that they presumably will have a limited absorption capability and which, on the other hand, ensure that those regions already enjoying assistance funds can expect to do so in future. Accordingly, subsidies to the "old" member states, which are to continue receiving half of the funds from the structural fund, will decline only slightly in real terms.

Sense of stability policy questionable

The aim of the European structural policy is to assist regions with below-average economic strength and thereby foster convergence within the EU. As in all statutory promotion measures, however, there is also the danger that undesirable incentives are created and that a transformation to a more efficient structure (with respect to the allocation of capital and labour) is thereby impeded. Sometimes, too, there appears to be insufficient consultation on the various European development objectives, and there is the danger of assisting some regions several times over. It therefore seems sensible to submit the EU's regional policy to a critical examination, too.

Sharing the burden of funding

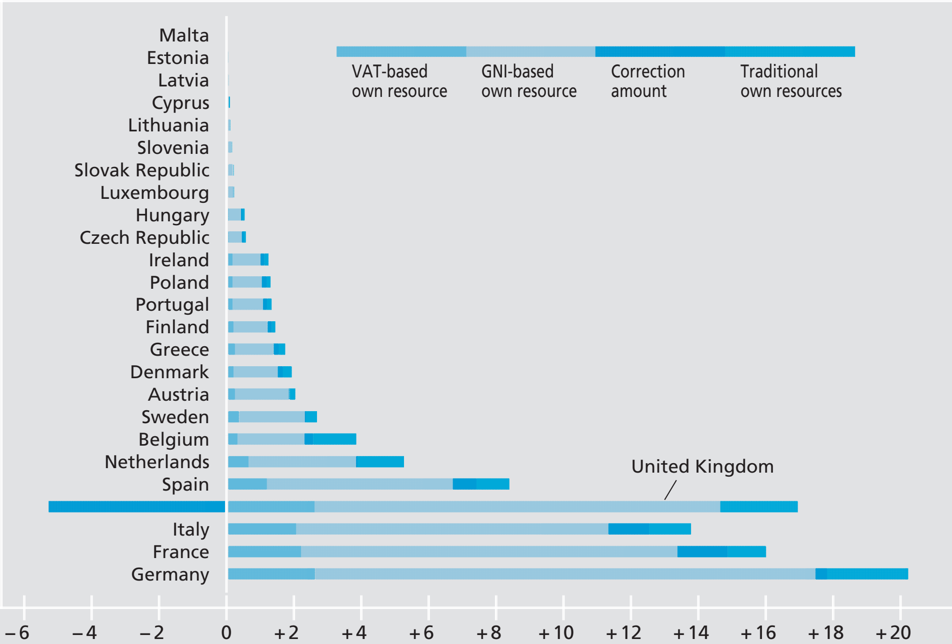
Correction of excessively large budget deficits

In 1999 (Agenda 2000) the European Council decided that the commission had to undertake a general review of the financing system by 1 January 2006 and suggest suitable changes. The commission based its proposal, which it submitted to the council in July 2004, on the general principle of the 1984 Fontainebleau agreement, which stated that "... any Member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time."[15] From this, the commission initially devised principal objectives for a general correction mechanism: unusually large net contributions by member states were to be avoided, the differences between net contributors with comparable wealth were to be reduced and the volume of income redistribution under the correction mechanism was to be limited to an acceptable level. The commission's proposal for

14 See European Commission, Third report on economic and social cohesion, 2004. The federal government assumes, however, that during the next assistance period up to 2013 eastern Germany can expect to receive further structural assistance as most of the regions concerned will remain Objective 1 areas. See Bundestags-Drucksache 15/5009 of 4 March 2005.
15 See the conclusion of the Fontainebleau European Council, Bulletin of the European Communities, 6–1984, paragraph 1.1.2. The operational budgetary balances calculated by the commission were used as a basis for this.

Own resources paid over to the EU by member state in 2004

€ billion



Source: Report by the European Commission on the allocation of EU expenditure by member state in 2004.

Deutsche Bundesbank

modifying the own resources system, which will probably continue to serve as a negotiating basis, essentially consists of the following elements:

– Threshold for budgetary deficits: the correction mechanism is to be applied whenever a member state's net payment exceeds a still unspecified percentage of GNI (eg 0.35%).

– Partial refund: correction consists of refunding part (eg two-thirds) of the amount exceeding the threshold.

– Limit for the total refund volume: if the sum of all corrections (eg €7.5 billion) exceeds the total predetermined volume, the refund rate is reduced accordingly.

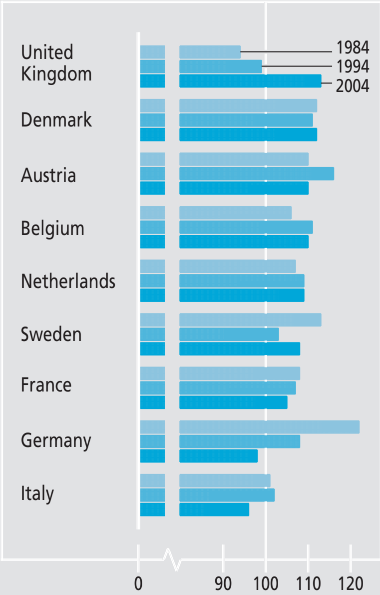
– Financing: the sum of all corrections is financed by all member states (including those eligible for relief) in proportion to their relative prosperity as measured by GNI.

Reform proposal entails both burdens and relief

The commission has illustrated the effects of its proposal by offering the aforementioned values as examples and shown the consequent shifts in the level of burdens to be expected between member states. The calculations are based on the commission's proposals for the new financial perspective. The resultant total refund volume (€7.5 billion) would therefore be roughly equivalent to the correction amount which the United Kingdom would receive if the present correction mechanism were continued (€7 billion in 2013). If the net budgetary balances resulting

Per capita GNI
of EU net contributors

Average of EU 15 = 100



Source: European Commission and Bundesbank calculations.

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from this mechanism were compared with those which would arise by retaining the existing system, the United Kingdom would be the member state that would lose most. Although its refund would decline from just over €5 billion in 2004 to an estimate of just over €2 billion, it would still receive the largest compensation amount. Almost all other member states would be financially better off than before. Germany, for example, could expect to receive relief amounting to 0.06% of GNI on average between 2008 and 2013, which is equivalent to a sum of just under €1½ billion. Moreover, the balances of the largest net contributors would converge. However, the mechanism does not necessarily result in the level of the net contributions being based on economic strength.

Transitional regulations for the United Kingdom

The commission believes that the system to compensate for excessive net budgetary balances should be introduced as early as 2007. To accommodate the financial interests of the United Kingdom it has suggested transitional regulations. In addition to the compensation amount calculated in accordance with the new mechanism, the United Kingdom is to be granted lump-sum payments of €5 billion between 2008 and 2011.[16] In order to limit the associated increase in the overall financing costs the partial refund for the other net contributors is to be gradually raised from (initially) only 33% to the targeted level of 66% in 2011. Only the refund level for the United Kingdom would be set at 66% throughout this period.

Conclusion

Still no agreement on financial perspective

Together with those of other net contributors the German government has advocated, in principle, an expenditure ceiling of no more than 1.0% of EU GNI. The sum of the commitment appropriations proposed by the commission over the entire planning period would then amount (at 2004 prices) to just €815 billion instead of the previously estimated €929 billion. Negotiations broke down in June 2005. The discussions held so far have shown that a compromise can be expected only if (a) the structure of the expenditure, especially the proportion spent on agriculture,

16 The largest net contributors (Germany, the Netherlands, Austria and Sweden) are to continue contributing only 25% of the calculated share of financing the correction amount.

is reformed and (b) the unilateral relief enjoyed by the United Kingdom is renegotiated.

EU subsidies are also to be critically reviewed

The debate on EU finances has essentially raised questions about the extent of centralisation, redistribution within the European Union and the tasks to be performed at the European level. The principle of subsidiarity enshrined in Article 5 of the EC Treaty argues – in cases of doubt – in favour of the fulfilment of tasks at national level and therefore advocates restricting the volume of the EU budget. The objective of strictly reviewing individual elements of government expenditure and, in particular, of consistently limiting subsidies in order, ultimately, to achieve a consolidation of public finances and a reduction in the persistently large contribution burden within the EU should also apply to the EU budget.

Agricultural sector needs further deregulation

The planned curb on agricultural subsidies is a step in the right direction. However, further reforms in this area are appropriate. Making the agricultural sector more open to international competition would be a case in point. One measure that could lead to a general reduction in subsidies and further limit the extent of the EU budget could possibly be financed jointly by the member states in a regulated manner. Germany would be likely to have its financial burden eased by such a reduction.

Simpler and more transparent structural policy desirable

In structural policy, too, greater attention should be paid to a transparent and efficient use of resources. With regard to supporting the catching-up process in the economically weaker member states, a strengthening of investment spending is especially important. Nevertheless, in this area, too, attention has to be paid to the risk of promoting ultimately uneconomic structures and of resources simply being rechannelled. It is also typically the case that it is very difficult to reduce subsidies once they have been granted. A stronger focus on assistance for member states with generally weaker economies might improve the targeting of resources since the other countries would no longer take the indirect course of financing via the EU budget. In the case of Germany, a greater concentration of EU structural funds resources would mainly affect the eastern regions. This would be accompanied by lower Federal government payments to the EU budget.

General correction mechanism would prevent excessive net amounts

The Commission’s proposal for a general correction mechanism for excessive budgetary deficits could help to prevent exceptionally large net contributions. However, this will not ensure that the level of such contributions is geared to economic performance. On the whole, it is welcome that this proposal represents an attempt to replace the present individual solutions with a single financing regulation.