

Managing diversity
for a growing Europe: a Romanian view on the
EU budgetary review process

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At the 2006 December Summit the European Council asked the Commission to carry out a review of the budget of the European Union by 2008/2009, paying particular attention to the Common Agricultural Policy and the own resources system.

In September 2007, the European Commission launched a Consultation Paper, which started the debate on the EU budget review. This document presents a Romanian, non-governmental view, which aims to contribute to this debate.

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Executive summary

The European Union is facing major exogenous and endogenous challenges. **Exogenous challenges** reside in the changing global context, which impacts on the development of the Union. Globalisation affects the status of the Union in the world, due to newly emerging global powers. There is an increased risk of massive illegal immigration, with implications concerning issues such as clash of civilisations and terrorist threats. Excessive dependence on third parties leads to insecurity and losses of bargaining power. The effects of global warming are increasingly worrying.

Endogenous challenges originate in the Union's unique character as a geopolitical entity. The Eastern Enlargement has increased the complexity of the Union. Ageing population and falling birth rates endanger the welfare systems. The functionality of the single market implies the existence of the four liberties and the free circulation of knowledge, conditions which still raise questions about their complete implementation. Re-location within the Union stirs dissatisfaction and rivalry among EU citizens and challenges the solidarity among the European nations.

When re-designing the budget to better tackle these challenges, there are several **principles** which need to be considered:

- The starting point should be the different realities in the Member States, and in particular, the variety of social and economic circumstances in Europe.
- Solidarity is fundamental
- The budget reform at the EU level should lead to national budget reforms in order to ensure synergy between European and national policy-making tools.
- The legal framework of the review/reform should be the Lisbon Treaty
- The review/reform of the EU budget should consider public opinion support for EU policies.
- No budget item should be dealt with separately, as policies are interdependent;

The **expenditure side of the EU budget** is examined by looking at the added-value of the EU action and what may constitute European public goods. What constitutes European public goods is a function of priorities that exist at the EU level, which hinge on the state of economies and societies.

The Common Agricultural Policy needs to be reformed in line with global challenges and inner pressures.

- There is increasing pressure on the demand for agricultural products due to the growing Asian economies, in particular. Also, there is considerable pressure on food supply due to effects of global warming on agricultural plots and sources of water.
- the rise in the prices of food on world markets diminishes considerably the need for agricultural subsidies in the EU. From an age of food surpluses (which originated the CAP) the world seems to be moving to an age of shortages.
- The CAP is questionable because the use of resources is questionable in terms of optimality and social equity. The answer to both problems, however, is not necessarily the further decoupling, because decoupling does not seem to work very well within the current structure of distribution of the direct aids.

A reform of the CAP should consider the following issues:

- Farmers are a particular category of society, and many of them have been threatened by globalisation side-effects. The rise in the prices of food does change the picture dramatically for European agriculture, but not a few farmers would continue to be in need of support for a while at least.
- The European production capacity of food must be valued and used so that the dependence on external sources of food supply should not become excessive
- Good quality land and water are European public goods of growing importance and should be managed accordingly, via the CAP too.
- There are other sectors and policies related to the CAP, which will be affected by the reform.
- Possible options for strengthening and diversifying rural economies.

A reform of the CAP should focus on a redistribution of expenditures within the CAP, possibly co-financed with the Member States, and improve the targeting of measures:

- More money should be allocated to the second pillar of CAP, focused on rural development.
- The sums allocated for the income-support objective for farms less than 5 ha should not diminish, as long as rural modernisation and economic diversification for possible displaced farmers to find other jobs; likewise the sums allocated to large farms should be phased-out in accordance with the rise in food prices on world markets.
- Crisis management schemes should be devised in order to confront delicate situations.
- Targeting can be improved by moving from multifunctional purposes to a clear distinction of objectives.

The Cohesion Policy is challenged by the high expectations stakeholders have from it to tackle various needs in Europe, by the threat of 're-nationalisation' , and by what we think is misdirected policy analysis to claim that the policy is responsible for re-location. The budget reform should not affect the Cohesion Policy envelope. Nonetheless it should lead to the consideration of the following elements, for a better use of Structural and Cohesion Funds (SCF):

- It is our opinion that the budget allocation for Cohesion Policy should be maintained or even increased.
- The Cohesion Policy has added-value, but there is a need to focus on results more than in the past.
- Improvements in the allocation efficiency of the SCF require both a better alignment of the national development plans with the EU policy priorities, and a better integration of the EU-wide strategic policy agenda into national development programs.
- Given the past experience of Ireland and Spain, the Cohesion Policy context could serve as a framework for anchoring national policy-making, especially in the new Member States.
- The SCF represent, in our opinion, an important instrument for accelerating real convergence within Europe, but the need to improve the allocation and efficiency of public spending, in general, remains an outstanding and sizeable challenge for many Member States.
- At national level, there is a need to improve consistency and clarify the strategic direction across policy products and processes.
- Integrating policy planning and budgeting across the government is central to sustaining growth and achieving the strategic objectives of convergence.
- More emphasis should be paid to developing medium term expenditure frameworks (MTEF) and budgets on programmes, to which the SCF should be an integral part and treated similarly to other financial resources.
- Improving absorption and effectiveness of SCF should also target the reform of the annual budget cycle in some members.
- There is a need to pay significantly more attention to upgrading the administrative capacity of SCF beneficiaries, especially at sub-national level, and of managing authorities.
- The economic rate of return of SCF projects should be given more prominence, which in turn requires more focus on developing project design skills.
- In order to improve the linkages between programs performance and resources allocated from the SCF, there is a need to strengthen monitoring and evaluation (M&E) systems.

To sum up, Cohesion Policy is one of the most important EU policies at the moment because it has the capacity and the potential to contribute to a cohesive development of the Union, with tools designed to manage the EU's socio-economic complexity. There is however considerable scope for improving its implementation.

Three aspects linked to the future of **R&D and competitiveness** policy of the EU are to be singled out:

- First, the EU funding for R&D and competitiveness does provide value for money. Impact assessments in general prove a high return of R&D investments, but there is substantial scope for greater efficiency.
- Second, there are more forms of R&D, more types of knowledge-based economies, and more types of competitiveness - depending on EU members' level of development. EU R&D expenditure should not relate exclusively to high value added R&D and high-end product innovation.
- Third, the management and implementation of these funds is just as important as the amounts.

It is essential to invest in centres of excellence in order to combat the brain drain within and from the EU. It is also extremely important to have free circulation and access to knowledge in order to increase the propensity of fast development all over the Union.

As a global actor, the European Union should consider the following issues:

- A better coordination between the Member States and the Commission and between the world donors could lead to more significant results in tackling issues in the developing world.
- In order to be a global actor, the European Union needs to be able to act coherently and fast at the world level. This implies the necessity of a common external policy which is supported by European resources.
- Ensuring security within and for the European Union is a European public good. Member States should intensify dialogue concerning this issue and the EU budget should contribute to this end.
- The EU needs to better integrate energy policy in its external actions and to allocate more resources to ensuring energy security. The Nabucco project could be supported by the EU budget as well.

The revenue side of the EU budget

- As it stands, the own resources system is not just, particularly because correction mechanisms have been designed to respond to and adjust imbalances that belong to the past. It is fundamental to reform expenditure in order to tackle own resources issues.
- Key to a functional system is pragmatism. We need a system that works; therefore it must be sufficient, stable, simple and equitable.
- A larger budget would be needed for the EU policies to be able to sensibly contribute to tackling challenges, however serious frauds in managing EU money impede an increase of the EU funding; there should be more focus on better management.

In consequence at the moment there is no scope for introducing new taxes, and contributions to the EU budget should continue to be GNI based. Provided that the management of the European funds improves, in the long term the EU

budget should be increased and new resources should be added to the existing ones.

The ***implementation*** of the eventual reform of the budget should be carried out gradually, preferably on the length of a Financial Perspective, in order to avoid the emergence of disequilibria. Moreover, for better management and accountability, the Financial Perspective span should be reduced to 5 years, similar to the mandate of the European Parliament and the Commission. Increased flexibility of the Financial Perspective is an issue that needs to be considered for better answering to unforeseen situations. It should be possible to have a European reserve or to transfer a certain proportion of funds among different headings, if necessary.

Introduction

For over half a century, Europe has emerged into a fairly integrated union of Member States. If initially, much of the integration process was inward looking, aimed at ensuring well-being within the Union's borders and extinguishing political rivalries of long vintage, the reality of the 21st century compels the EU to re-examine itself. An inward looking approach is not anymore sufficient. Globalisation, security of energy supply, the rise in food and energy prices, global warming, and the enormous progress of Asian economies are some of the new challenges that the EU needs to deal with in order to maintain and further develop the well-being of its citizens.

The review and reform of its budget are essential steps that the Union must take in order to increase its capacity of facing major challenges in the 21st century. The European Commission's Consultation Paper on reviewing the EU budget is more than welcome. A review on principles and content with no taboos and where everything is examined is a suitable approach for fostering the debate. The results of the consultation process will most likely be the basis for an eventual reform of the EU budget.

This paper presents a view concerning the budgetary review. It does not represent a governmental Romanian position or a very detailed analysis. It is rather a reflection of our thoughts on how the EU budget could better serve the interests of the Union's citizens in the years to come, focused on the current main budget items in relation to both internal and external challenges of the Union. It is right to stress, however, that the view mirrors the reality of a relatively poor European society. Our aim is to think in European terms while not overlooking the peculiar challenges an emerging economy (with a relatively large rural population) is facing.

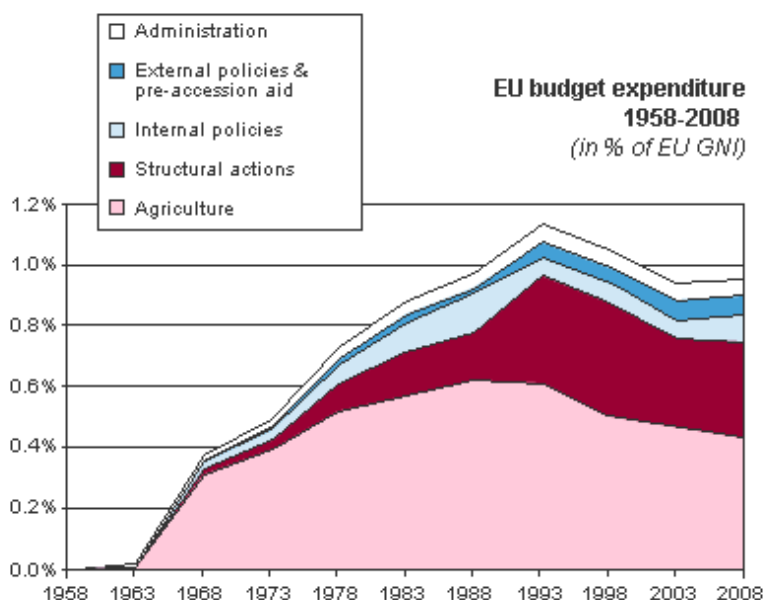
The first section addresses the evolution of the EU budget into becoming the lowest common denominator among the Member States and European Institutions' interests. The second section refers to major challenges that beset the Union and their implications for its budget. The third part tackles the principles that the budget review and eventual reform should be based on. The fourth section regards what actually could be reformed on both the expenditure and the revenue sides of the budget. The last section discusses issues related to the implementation of the reform.

1. The EU budget: a small economic instrument of great political clout

- ***Compared to federal or national budgets, the EU budget is small and cannot be used as a macroeconomic tool.***

Initially, the Community budget was a mere fund of less than 0.01% of the average Community GNP¹, which covered only administrative expenditures (see Fig. 1). It was the creation of the Common Agricultural Policy (CAP) that boosted the budget to ceilings close to 0.5% of the average Community GNI in the 1970s. The accession of new Member States in 1973 (Ireland, Denmark and the UK), 1981 (Greece) and 1985 (Portugal and Spain), some of which were less interested in the CAP and were facing structural problems posed by industrial re-conversion and poor infrastructure development, and the need to support the internal market project, led to the emergence and the development of the Cohesion Policy, as the second largest item of the budget expenditure.

Fig. 1: The Evolution of EU Budget Expenditure



Source: European Commission (http://ec.europa.eu/budget/reform/history/history1957_en.htm)

- ***Despite the ascending trend of the Community budget and the expenditure diversification, it became increasingly hard to reach agreement on the budget among the Member States on the one hand, and among the European institutions, on the other hand.***

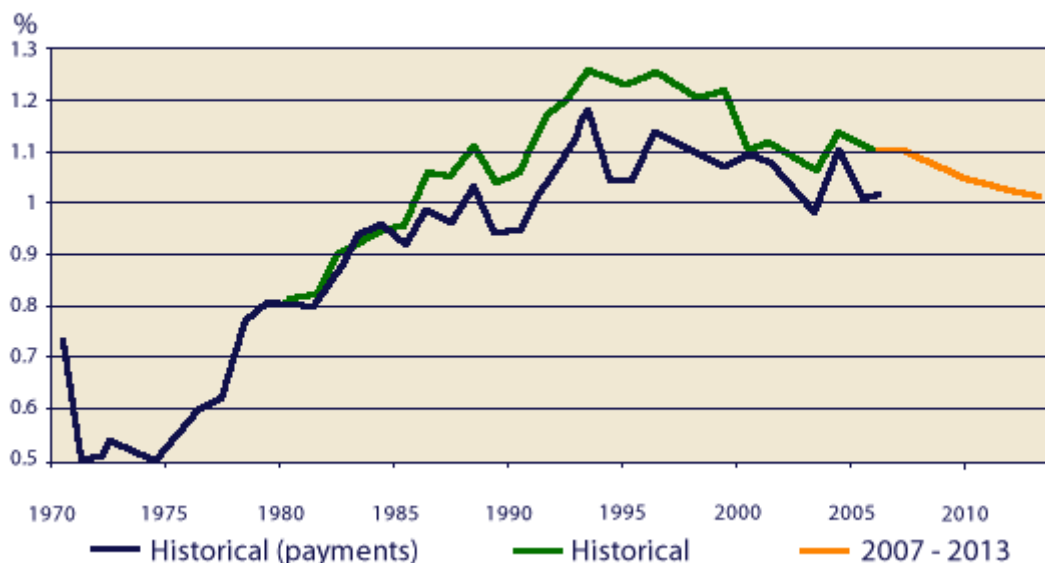
The classic conflict between net-contributors and net-beneficiaries was supplemented by the socio-economic specificities of each Member State. These specificities materialised in numerous additional provisions, policy orientations, and side-deals in the budget expenditure, and in the emergence of correction

¹ GNP stands for Gross National Product.

mechanisms in the budget revenue². The increase in the European Parliament's legitimacy and power over the budget, and its disagreements with the European Commission and the Council almost led to a decision-making deadlock in the 1980, when the Parliament twice rejected the Community budget. The introduction of the Inter-institutional Agreements (1982) and of the Financial Perspectives (1988) was meant to minimise these issues by setting binding multi-annual expenditure ceilings and limiting agriculture expenditure, and by capping the own resources at a maximum of 1.20% of the Community GNP. The Inter-institutional Agreement between the Commission, the Council and the Parliament guarantees the cooperation among these institutions for the annual budgets, according to the framework set by the Financial Perspectives.

The Eastern Enlargement has further challenged the EU budget. The Central and Eastern European EU candidate countries have economies with GDP³s severely below the Union's average (as low as 35% of the EU15 average GDP), in need of infrastructure development and with a high proportion of the labour force occupied in agriculture and older industries. A continuation of the financial assistance under CAP and Cohesion Policy without alterations would have led the EU budget expenditure way above the own resources limit of 1.27% of the EU GNP⁴.

Fig. 2: Evolution of EU budget commitments as a % of EU GNI, 1972-2013



Source: The UK Foreign and Commonwealth Office

An increase of the EU budget revenue was not an option that the net-contributors were willing to take given the strains posed by the conditions of implementing the Economic and Monetary Union (EMU) and the decreasing public opinion support for European integration. Furthermore, globalisation and

² The first correction mechanism was the UK rebate, introduced at the 1984 Fontainebleau Summit.

³ GDP stands for Gross Domestic Product.

⁴ The 1.27% ceiling was established by the 1992-1999 Financial Perspectives. This was changed in 2002 with the GNP/GNI change on National Accounts and recalculated at 1.24% GNI (Gross National Income).

increasing world competition, on the background of slowed economic growth in Western Europe, compelled and still drive the net-contributors towards an attitude, where the solidarity with one country's citizens comes, often, at the expense of the solidarity with other European states. Consequently, the 2000-2006 Financial Perspectives for the first time established a cap for European financial assistance at 4% of Member States' GDP and the own resources correction mechanisms were extended to Sweden, Germany and the Netherlands. The 2007-2013 Financial Perspectives, were agreed with more additional provisions than previous frameworks (only Cohesion Policy contains 17 additional provisions, out of which just four concern the new Member States) and maintained the correction mechanisms for the four net-contributors (the UK, Sweden, The Netherlands and Germany). Furthermore, although the own resources cap was established at 1.24% EU GNI average, for the first time, the budget of the Union decreased to 1.045% of the average EU GNI, out of which less than 1% will be used in real terms (see Fig. 2); this decrease is quite telling as to the propensity of donors to raise the EU budget.

- ***A fundamental condition for having an operational EU budget is solidarity among Member States. Arguably, a more effective EU budget should not be capped at merely 1% EU GNI average, as a matter of principle, and should not have special provisions or correction mechanisms.***

There are three major causes for the current structure of the EU budget, which impede its further development. First, the Community budget must respond to different and sometimes conflicting national interests and to different integration paradigms. It is an open secret that there has been an ongoing dispute between those who favour deeper integration and those who would rather see the EU in a looser form for decades now. The EU budget is also influenced by an inter-institutional quest for power. Consequently, the EU budget is a lowest common denominator among Member States and among EU institutions. Second, the side-effects of globalisation influence the Member States' protectionist behaviour at the European level and negatively impacts on their willingness to redistribute their resources throughout the Union. Third, the mismanagement of EU funds triggers more support for subsidiarity and more national competences in the EU policy-making. There is, therefore, greater reluctance for transferring competences, responsibility and resources at the European level.

- ***Although, politically, it is a unique joint effort of a large number of countries, which chose to put together their resources for common goals, the EU budget remains an economic tool of low impact.***

The challenges that the Union is facing externally and internally call for a deeper reflection concerning the purpose, the structure and the size of the EU budget.

2. The European Union in the new global context

The European Union is the most successful peace project that humankind has created so far. The post-war period was a rough test for the European nations in terms of political and economic recovery. Poverty, scarcity of food and avoiding another destructive war were then the main challenges to which the founding fathers tried to answer by putting in place the European project. At a time when state intervention was needed to sustain and develop food production, the creation of a Common Agricultural Policy (CAP) was an appropriate tool to solve the needs of then six Member States. Moreover, the increased interdependence among the European states led to the creation of the Single Market, a significant economic block at the world level. Today we all agree that the plans of the founding fathers paid off. Europe recovered economically and has enjoyed the longest peace period in its history.

Nonetheless, the global context has fundamentally changed during the past decades. The Union has deepened and widened and currently faces powerful exogenous as well as endogenous pressures. In a dynamic world, the Union is required to prove its own ability to act and maintain itself as a major actor on the global scene. At the same time, a big internal challenge is to manage its own growing complexity. This section addresses the challenges facing the European Union and explores the means by which they can be tackled. These challenges cannot leave the EU budget unaffected.

2.1 Exogenous challenges

Globalisation *per se* is the overarching exogenous challenge to the Union. It is a phenomenon that embeds a range of variables. Globalisation creates winners and losers. It stimulates development, economic growth and technological progress, but not evenly and ubiquitously. At the same time, its less benign effects bear on labour force, the environment, and security concerns. Interdependence leads to greater difficulties in tackling global and environmental issues and can make international financial markets more fragile. The dangers of re-location and stiff competition cause protectionist attitudes in the wealthier countries of the world, which in turn increase poverty in developing areas and lead to massive illegal immigration to prosperous regions. For the European Union globalisation has materialised in a series of sources of pressure, as follows:

- ***The status of the European Union in the world is at stake in the context of newly emerging global powers.***

If the 19th century was the century of European leadership and the 20th century was that of American leadership, the 21st century will, probably, belong to the booming Asian economies. The challenge for the European Union is to speed up its economic growth and enhance its vigour in order to face its competitors. The European Union responded to global competitive pressures by launching the Lisbon Strategy, aiming to become the most competitive and dynamic knowledge-based economic area in the world by 2010⁵. This overall goal sounds quite presumptuous and, maybe, wishful thinking. In addition, some would argue that one-sided emphasis competitiveness can strain 'the European social model'. But the goal reflects a 'prise de conscience' as to the rapidly and dramatically changing global environment.

A refocus of EU and Member States' actions on increasing competitiveness by fostering innovation and technology development and investing in education is a sensible approach. However, the implementation of such measures in practice is not straightforward and there is a common agreement among policy-makers and academics that much more needs to be done⁶. The very rising complexity of the Union limits the extent to which a comprehensive strategy can be designed at the European level.

The approach for achieving the Lisbon goals of several EU Member States is already a highly valuable experience. In particular, the reform experience of the Scandinavian countries in the past decade is a major lesson for the rest of the EU. Regardless of how different national circumstances may be, it is also a lesson about the potency of national policy-making. Increasing EU competitiveness translates into more adaptive social structures, more R&D and more flexible markets.

The EU Member States have different internal characteristics and may design different strategies to tackle the tension between fostering economic growth and reforming their social systems. However, for maximising outcomes, Member States should better channel their actions towards priorities (major goals) and learn from each other. There should be more cross-border dialogue when designing strategies. The EU budget can act as a lever and foster better results if more resources are allocated for enhancing competitiveness, for raising R&D.

- ***There is an increased risk of massive illegal immigration, with implications concerning issues such as clash of civilisations and terrorist threats.***

This is due to less benign aspects (efforts) of globalisation and demographic dynamics in Europe. Despite enlargement fatigue, the Union is still subject to a process of increasing its territory, with the pending accession of other Balkan

⁵European Council Conclusions, March 2000.

⁶Please see A. Sapir (2003); W. Kok (2004); and the strategic report on the Lisbon Strategy for launching the new cycle (2008-2010).

countries. The Consultation Paper of the Commission rightly indicates that the Union's borders are extending closer to less developed areas, which are increasingly adversely affected by globalisation side-effects. Massive illegal immigration, clash of civilisations (to use Samuel Huntington's terminology) and terrorist threats are major challenges. These issues demand a two-fold focus of the EU action. Internally, the priorities are to strengthen the Union borders, to design comprehensive and common (where it is possible) European immigration and asylum policies, and to facilitate inter-cultural dialogue and understanding, easing the integration of immigrants within the European societies. The EU budget is part of the instrument-mix to use as a response to the needs in this area.

Externally, the EU's goal to be a global actor asks for an active approach and joint actions with other world powers to tackle problems in the less developed areas of the world, and not only of a financial kind. Currently the EU is the largest world donor of external aid. Still, greater efforts are required. Issues such as containing and combating diseases in the third world, securing drinkable water, and fighting poverty around the world, reviewing the Doha Trade Round make up an urgent agenda to be addressed in a more structural way.

A reduction in the protectionist measures of the wealthier countries would allow more fair trade and easier market access for non-subsidised agricultural products from less developed areas. Yet, this would lead to significant harm in the European agricultural sector, in the short run, and would increase dependence on other areas of the world, making Europe more vulnerable. One cannot oppose globalisation; this is certain. However, one can find more appropriate strategies to benefit from it and minimise its side-effects. Protectionism is not the solution, nor is unconstrained liberalisation.

The Union and its budget are challenged to find an appropriate balance between openness for fostering growth, and ensuring that its citizens are not paying unfair costs, as well as not succumbing to policy oversimplifications and fundamentalism⁷. Finding an appropriate balance brings to the fore an ethical dimension of EU policies. This dimension regards both the people of the developing world and EU's own citizens. The role of the EU budget in this context is to sustain phasing-out mechanisms and re-orientation programmes for those whose subsidies are cut, and at the same time, to sustain together with the Member States, developing programmes in the third world and crisis management actions in conflict areas.

- ***Excessive dependence on third parties leads to insecurity and losses of bargaining power and should be avoided, particularly when at stake are strategic commodities, like energy.***

Currently half of the energy needs of the European Union are ensured via imports. By 2030, the proportion of imports will reach 65% of total consumption (Belkin, 2007). Most imports come from Russia and the Middle East. The latter

⁷ One example of fundamentalism is the inability to distinguish between liberalisation and deregulation.

is an area which is subject to instability and the quality of EU-Russian relations has been fluctuating over time. Oil and gas are and will be highly strategic commodities. The competition for oil and gas fields will intensify in the years to come, due to both supply and demand side dynamics; the latter being influenced mainly by the very fast development of Asian economies. How this competition would evolve in the future is a reason of concern for all Member States, as is nuclear proliferation, which may develop intensely under the guise of the quest for more renewable energy. These challenges demand a carefully tailored joint approach, due to the implications it may have for the Member States' and Union's external relations. Ensuring energy security is a fundamental prerequisite for the Union to sustain its growth targets and to remain a global actor in the long run. More efficient and ecologic energy supply capabilities must be developed in order to minimise dependence on third parties.

- ***The effects of global warming are increasingly visible and worrying. The need for growth and development can strongly collide with ecological concerns unless a new development paradigm is implemented.***

By signing the Kyoto Protocol and setting ambitious targets for the reduction of CO₂ emissions⁸, the EU has assumed a leading role and sets an example for increasing environmental protection standards. The economic costs of such measures are not fully anticipated and visible yet, but are a factor to be considered in designing future policy approaches. In this case again, a balance must be struck between protecting the environment and making sure that economic growth is not hindered excessively. It is noteworthy that very powerful individual lobbies are showing their teeth in order to combat the programme of dealing with global warming.

Climate change and the economic rise of Asia give salience to food resources as future strategic commodities. This would, logically, impart to CAP reform a strategic component which does not seem to be taken into account sufficiently now.

- ***The key for an appropriate internalisation of globalisation challenges is ensuring a sustainable set of policies.***

As some cogently argue the combination of low growth and high public expenditure is not viable in the long run (Sapir et al, 2003). The pressure for intense competition strains the welfare state and frustrates trade unions and citizens. The result materialises in policy trade-offs, as those outlined above. These contradictions and the magnitude of the emerging challenges lead to the creation of an international policy agenda defined by issues such as: fair versus free trade, protecting the environment as a global public good, tackling abject poverty, combating non-conventional threats (including terrorism), or dealing with massive illegal migration. The dramatic changes under way open up the

⁸ On 23rd of January, the European Commission proposed a legislative package, which will enable the Union to achieve its ambitious targets in CO₂ emissions and the development of renewable energy.

possibility for co-operative relationships, but also for new tensions. One may consider, in this regard, the growing need for energy and basic commodities in Asia, with China and India as the prime consumers, the unresolved geopolitical crises in various parts of the world, nuclear proliferation, and the struggle against terrorism.

It is noteworthy that there is a growing awareness that there are issues that need to be addressed at the international level, in a multilateral context and using collaborative approaches. The Davos Forum this year has talked about innovative partnerships. In this context the role of the Union is important as it is the most integrated geo-political region of the world and can be a model of cooperation among countries. There is a need for international public goods, which can provide an alternative for national governments' protectionist reaction to increasing pressure from foreign markets and globalisation threats. The EU Member States can benefit from the synergy of being more integrated and of having the experience of working together. The budget is one of the tools that the Union has and must be geared towards providing European public goods as an answer to major challenges. A solid answer is based on the sustainability of European actions, which can be ensured, provided that the unique character of the Union is considered. But this character also brings about sources of internal pressure.

2.2 Endogenous challenges

*In varietate concordia*⁹ is Europe's current demos. It fully reflects the key characteristics of the European Union: complex and united. The degree of unity is fundamental to the means by which complexity is addressed within the Union. Managing complexity is the greatest inner challenge that the EU has to face. There is a series of common internal EU challenges which originate in a sort of institutional sclerosis, ageing population and demographics, cross-border cooperation, preserving/developing welfare standards, the functioning of the internal market and further deepening and widening the Union. These challenges test the Member States' ability to tackle them in a unified way.

There are too, among others, internal issues that place Member States on opposite sides or specific clusters; these issues refer to re-location, economic and institutional reforms, and absorption of EU funds.

- ***The Eastern Enlargement has increased the complexity of the Union, posing greater challenges for its management as an integrated system.***

Complexity is embedded in political, economic, social and cultural dimensions. The integration process is shaped by conflicting paradigms: Advocates of

⁹ United in diversity

federalist approaches to integration clash with those defending the intergovernmental view. President Barroso states in the Consultation Paper that the review is about a 'vision for Europe'. This is very hard to reach when on the federalist - intergovernmental axis, Member States are divided in several constellations and have different visions for Europe. These visions are mirrored in the various and sometimes opposing national interests, and in the clashes of different interpretations of challenges and opportunities for the Union.

From the political perspective, the size of the EU budget is paramount, particularly for those who reject transfers of national sovereignty to the European level. From the economic point of view, the EU budget is, basically, a redistribution tool, and its impact is far from what federalists would have envisaged. The very size and structure of the EU budget is a result of the EU complexity and illustrates the Union's metabolism.

The successive waves of enlargement have increased further the variable geometry within the Union, particularly concerning social and economic variety. The European Union reveals several forms of its arch-typical model. One can distinguish among a Scandinavian, a so-called 'continental capitalism', a Mediterranean type, and an Anglo-Saxon type. In between are sub-models characteristic for the new Member States. All of them share basic features of the European social model. The Union is strained by an apparent contradiction between its well entrenched welfare models that it wants to preserve and the need to make markets more flexible in order to strengthen economic growth and diminish unemployment. The rising variety of economic and social conditions, particularly with the Eastern Enlargement, and the broadening range of divergent policy needs and views among member countries concerning the challenges they face and the appropriate means to tackle them risk bringing policy coordination and EU policy-making to a standstill. The adoption of the Lisbon Treaty can be judged in this context as well. This tension will affect the review process and the future reform of the budget, hindering objective decisions on budget and policy design.

- ***The Union is hampered by its own institutional structure, which has not evolved according to the needs imposed by its growing complexity.***

An increasing number of policy areas are affected by deadlocks, as it is the case with the blockage in reforming educational systems, the pension systems, or in enhancing R&D in both private and public sectors. Reforms are essential in order to tackle globalisation challenges. The current institutional set-up impedes these reforms. If the Lisbon Agenda was the EU answer to globalisation challenges, the Lisbon Treaty is an attempt to streamline the malfunctioning institutions that slow down and sometimes block policy reform and successful implementation. The Lisbon Treaty extends the powers of the European Parliament to the entire budget, making a step forward in tackling the democratic deficit within the Union. An eventual reform of the budget itself should streamline further decision-making, particularly concerning the Financial Perspectives, by re-focusing the budget on providing European public goods that are in all Member States' interest.

- ***Ageing population and falling birth rates endanger the welfare state systems. Social protection by the state is no longer feasible, as it used to be, with continuous early retirement and decreasing active labour force.***

European policy-makers showed a unified will to tackle these challenges through the Lisbon and Gothenburg Agendas. Nonetheless, employment and training targets have not been fully reached yet, particularly in the new Member States, and the life-long learning process has not been implemented adequately¹⁰. The EU budget ought to and can contribute to tackling Europe's demographic problem by supporting further development of life-long learning initiatives and facilitating education and integration of immigrants. However, given the size and the salience of these issues, it is ever more important for the national governments to coordinate their policies, as they dispose of more powerful instruments than the Union does.

- ***The functionality of the single market implies the existence of the four liberties and the free circulation of knowledge¹¹, conditions which still raise issues about their complete implementation.***

Challenges such as migration within the Union, and ensuring security of external borders are just among the few to mention here. Too much migration may have a trigger function and lead to disequilibria, besides the already emerging tensions concerning the residents from Central and Eastern Europe in some of the EU15 Member States¹². The functioning of the labour markets opposes insiders to outsiders. This division is symptomatic for the erosion of social cohesion. A proper harmonisation of the European space can lead to balanced development, avoiding shocks. This requires differentiated policy measures adapted to the economic and geographical specificities of the Union. A better instrument mix can address this challenge. The EU budget is not meant to have the main role in this case. Regulatory tools are more suitable. Nonetheless, the EU budget can contribute to improving the circulation of services and knowledge by investing in high-tech communication facilities and networks.

- ***Re-location within the Union can raise unemployment in old Member States and increase foreign investment and create jobs in the new ones. It stirs dissatisfaction and rivalry among EU citizens and challenges the solidarity between European nations.***

Many voices have expressed their fears over the consequences of the increasing outsourcing and off-shoring activities by the private sector¹³. The

¹⁰ Please see and the strategic report on the Lisbon Strategy for launching the new cycle (2008-2010).

¹¹ The European Commission refers to knowledge as the 'fifth freedom' of the Single Market (COM(2007) 803 final).

¹² See, for instance, the 'Polish plumber' issue in the UK, and the tensions in Italy and Spain related to Romanian workers.

¹³ See, for instance, the recent Nokia decision to move a plant out of Germany in Cluj, Romania.

new Member States were blamed for allegedly practicing unfair competition via lower taxes, which would further attract jobs to Eastern Europe. This opens the way to a misdirected path in assessing EU policies. Structural Funds, for instance, can be seen as an overall subsidy provided by the EU to its least developed Member States, apart from a policy resulted from a sense of solidarity among EU countries and a practical means to foster cohesion across frontiers. The consequence is that advanced economies, which have been supporters of free trade and open markets, return to economic nationalism. Cohesion in the Union could be enhanced if policies were designed for the West and the East in order to bring them closer together. These policies would help achieve real convergence.

The EU budget can play an identity-enhancing role and develop a sense of ownership of and belonging to the Union. More involvement of the EU citizens in understanding and responding to change will increase support for European public policies and goods.

- ***The process of EU deepening and widening has to evolve in conjunction and as a response to external challenges, despite claims of integration stagnation induced in relation to the new provisions of Lisbon Treaty¹⁴.***

Some of the new Member States still need to integrate into the Schengen Area and eventually adopt the euro, as part of their accession obligations. The pressure of implementing the Maastricht criteria can hinder their faster economic development. There are, too, serious issues to address related to increasing absorption capacity. Further enlargement to include the Western Balkans is a must, and a condition for preserving security within the continent. Moreover, were it to take place, the accession of Turkey in the Union would increase Europe's geo-political reach and control over energy sources and transportation routes. Nonetheless, the accession of Turkey would add several other dimensions to the Union's complexity and it would also be a tough economic and cultural challenge.

Given the endogenous and exogenous challenges mentioned above it is obvious that the Union needs to achieve a higher economic growth. At the same time, it is clear that the traditional welfare European state is not feasible anymore. Reforms are needed in this regard. In consequence, the social contract between citizens and their nation states and between citizens and the Union must be redefined in such a way that sustainable economic growth does not impair social cohesion, and is accompanied by an adequate production of European public goods. The EU budget review is part of the redefinition of the social contract with the citizens of the Union. The budget must act as a lever for the development of a self-confident EU, internally and in the world.

¹⁴ The Treaty clarifies that the European Union is a union of Member States (See in particular Art.1-6, Reform Treaty).

3. Principles of the Reform

There is a general agreement that the EU budget needs reform. The budget review is the first step in this direction. The issue is however, where we want the EU to be and how much we are prepared to pay for it. In order to ensure that it is feasible, the budget review and the future reform of the budget need to take into account several principles. They should have as a starting point the complexity of the Union, thus the realities in all the Member States. They must consider the Treaty provisions, as well as the principle of solidarity and public opinion. And finally, they must lead to a better coordination of EU policies. In consequence, all policy items must be dealt with at the same time.

- ***It is sensible to say that the starting point of the review/reform should be the different realities in the Member States.***

Earlier, it has been stated that managing its complexity is the biggest challenge that the Union has, because complexity is intrinsically linked to the Union's existence in diversity. A discussion over the EU budget should lead to a budgetary structure that better answers the current EU priorities. This implies considering the Union's complexity, and in particular the variety of economic and social circumstances. The inferior economic situation of the new Member States, some with GDPs of one or two thirds of the Union average, should be considered. It would be unreasonable to design a budget that worsens the situation of the new Member States. This is also one of the reasons why the transition to a newly shaped budget should be gradual, and phasing-out/in strategies should be designed.

- ***The focus of the review/reform should be towards a more coherent and better targeted EU action.***

No budget item should be dealt with separately, as policies are interdependent and one should avoid the possibility of developing overlapping and/or contradictory policy measures.

- ***Solidarity must apply***

Thus a newly designed budget needs to be advantageous for all the Member States and for the Union as a whole. This should not be understood as a new reading of the *juste retour* approach. On the contrary, any change in the budget structure should lead to an increase in the added-value of European intervention, which would benefit the entire European Union, by improving resource allocation.

- ***The Lisbon Treaty, if ratified¹⁵, will be the new basis for EU primary law, and therefore, will set the framework of the review/reform.***

For the first time, the Treaty defines the types of competences that the EU may have in policy making and allocates policies according to this classification¹⁶ (Art. 2-6, Treaty on the Functioning of the EU (TFEU)). It sets new provisions for the area of freedom, security and justice, for energy policy, which is upgraded to shared competences, and for external relations, reflecting increased political will to jointly manage these issues. Old policies still have an important basis in the Treaty. Their objectives are maintained, as it is the case for the CAP, or even strengthened, in the case of Cohesion Policy. The latter is targeted not only at economic and social cohesion, but also at territorial cohesion and there is a stronger emphasis on solidarity among Member States.

The Treaty clarifies that any EU action must respect three fundamental principles: conferral¹⁷, subsidiarity¹⁸ and proportionality¹⁹ (Art. 5 Reform Treaty). The application of the principles of subsidiarity and proportionality should establish the added-value of EU intervention. Consequently, current EU policies should be subject to a value-added test, according to these principles. Any policy, which is not a Union exclusive competence, which has a Treaty basis and passes the test posed by the principles of subsidiarity and proportionality, should be reflected in the budget, should financial means be the most appropriate instruments for its implementation.

As for the own resources of the EU budget, the Lisbon Treaty has new provisions in this regard and explicitly specifies the possibility of introducing new resources, as well as the possibility of eliminating old ones. This indicates that for the first time there is awareness at the political level that a better response to the challenges of the 21st century also entails a reform of the own resources system of the Union and opens the way to overtly debate this issue.

¹⁵ To date (5th of March 2008) Hungary, Malta, Slovenia, Romania and France have ratified the Treaty.

¹⁶ Exclusive competencies: the customs union; the common commercial policy, competition policy for the proper functioning of the internal market; monetary policy for the Member States that are members of the Eurozone; and conservation of biodiversity under the common fisheries policy.

Shared competencies: the internal market; social policy for the aspects referred to in the Treaty; economic, social and territorial cohesion; agriculture and fisheries (excluding biodiversity); environment; consumer protection; transport and TENs; energy; research and technological development and space; the area of freedom, security and justice; and common safety concerns in public health.

EU actions to support, coordinate and supplement those of the Member States: protection and improvement of human health, industry, culture and tourism, education and vocational training, youth and sport, civil protection and administrative cooperation.

¹⁷ The principle of conferral states that the Union shall act only within the limits of the competences conferred upon it by the Member States.

¹⁸ The principle of subsidiarity applies for the areas that do not fall under exclusive competences of the Union and states that the Union shall act only in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central, regional or local level, but can rather by reason of scale and effects of the proposed action, be better achieved at the Union level.

¹⁹ The principle of proportionality establishes that the content and form of the Union action shall not exceed what is necessary to achieve the objectives of the Treaties.

- ***Any reform of the EU budget in the future should consider public opinion support for EU policies.***

Although previous reforms have been carried out without particular attention to the public opinion, the French and the Dutch 'no' to the Constitutional Treaty revealed the size of the democratic deficit and the necessity to consider public opinion in European deliberations. A simple survey of the Eurobarometer publications on European public opinion indicates that there is great support for European level decision-making concerning research and technology, environmental protection, energy policy, foreign affairs, immigration and security, and cooperation with the third world. Some of these issues are priorities already reflected in the Lisbon Agenda. Consequently, a refocus of the budgetary expenditure towards these areas seems to be fully justified. It is noteworthy also that the same Eurobarometer results indicate constant and fairly high support for EU competences in agriculture and cohesion policies, despite these being blamed, by some, as 'old policies', which are unable to respond to today's challenges. A sudden cut in the allocations for these policies would not be welcome by a considerable part of the European public in both new and old Member States.

- ***Finally, the review and reform of the EU budget should lead to a reform of the national budgets.***

This is essential in order to ensure the compatibility and synergy of EU and national policy-making instruments. Regardless of the issues that the EU budget would tackle, it would be impossible for the EU action alone to provide solutions. One needs coherent actions at all policy-making levels.

The Commission's consultation paper raises the issue of EU budget's capacity to respond to changing needs. Both public opinion and political will indicate that there is scope for more concentration on forward-looking challenges (as these are reflected by the Lisbon Agenda and its external dimension) and the promotion of the European values and standards to the out-side world. Moreover, the same indicators show that old policies are still on the agenda, thus equilibrium must be found between continuity and change. The question is not necessarily about what policies should suffer cuts in the budgetary expenditure, it is also about whether new implementation means can be designed to improve policy effectiveness, and to increase the budget's capacity of better answering to new challenges.

4. Reviewing and reforming the budget: concrete measures to take

Previous sections address the exogenous and endogenous challenges to the Union and the principles that the review/reform should consider. These challenges and principles establish, in our opinion, the context for analysing concrete measures to take for updating the European budget. This section of the paper approaches both expenditure and revenue related issues.

4.1. Expenditure

- ***The EU budget should act as a lever to the policy priorities financed through national budgets, which should aim in the same direction.***

An adequate supply of European public goods is one of the ways to address the EU challenges and the budget should contribute to that. One needs clear criteria, first to establish what qualifies as a European public good, and second, to decide on the most appropriate instrument mix to ensure its supply; hence the extent to which the EU budget can and should contribute to this objective. Expenditure is examined by looking at the added-value of the EU action and what may constitute European public goods. Key policy cases are also addressed.

4.1.1. Financing European Public Goods

- ***The issue of European public goods is a dynamic concept. What constitutes European public goods is a function of the priorities that exist at the EU level. These priorities hinge on the state of economies and societies and change according to inner and outer challenges.***

There is a set of criteria that may apply in order to establish what would constitute (European) public goods, and consequently areas where intervention at the EU level is justified, bringing added-value to Member States' cooperation. First, fiscal federalism (Tresch, 2002) offers standard economic criteria to assess the added-value of EU action. According to an economic interpretation, EU action is justified only in cases of market failure, i.e. the existence of economies of scale or scope, and of spillovers caused by externalities. Nonetheless, EU added-value is a complex concept and cannot be captured only through economic criteria. It has several political connotations, among which advancing EU aims and promoting the EU values outside the European Union, maintaining and developing the international salience of the EU block, and ultimately ensuring a stable geo-political state of affairs in the European region and promoting solidarity among the Member States. In addition, cost-

benefit analysis, which is undertaken in a narrow framework, can be misleading. For example, one cannot internalise all imaginable effects of climate change and future generations cannot vote when we decide about their future.

Second, the Treaty establishes that subsidiarity and proportionality are the essential criteria to assess the necessity of EU intervention, and its added-value potential. The principle of subsidiarity clearly states that EU intervention should take place only if 'the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at the central level or at regional and local level, but can rather, by reason of scale or effects...be better achieved at Union level' (Art. 5, Reform Treaty). The principle of proportionality limits the content and form of the EU action solely to what is necessary to achieve the objectives set in the Treaties.

Member States themselves have already agreed on strengthening their joint action in a series of areas. In that sense, European public goods are energy security, environmental protection, security and cross-border cooperation, and Lisbon Agenda targets. Besides these, there are European public goods which tend to be overlooked by current debates, but whose importance is rapidly increasing. For example, in the context of climate change and the necessity of increasing internal energy supply, fertile soils are a powerful asset, which needs to be strategically rated and used. Central and Eastern Europe, and Romania in particular, is rich in such soils. A new focus of the CAP towards better management of agricultural assets is the appropriate way to go forward, and should make use of all suitable tools.

Furthermore, there is an added-value of the EU budget itself, which is, frequently, ignored by some. Although economically speaking, it is small and does not have the necessary power to act as a milieu-shaping and regulatory tool, as it is the case with national budgets, the EU budget has so far been a political asset for the Union. It does have a compensation function in the decision-making process (Ederlein et al, 2007). It has acted as a consensus instrument, enabling the EU to deepen and widen, ensuring at the same time that each Member State benefits somehow from the process. This is regarded by some as a negative function of the budget, supporting the *juste retour* principle. This is not necessarily the case. It has been stated earlier that the greatest internal challenge of the EU is to manage its own complexity. The budget currently is a tool that helps tackling complexity by answering to the differentiated needs of the Member States and supporting a win-win approach to decision-making. It is questionable whether this character of the EU budget will ever disappear. One needs a radical change in the way Member States perceive their Union membership. Nonetheless, efforts should be made in order to improve the capacity of the Union to better respond to internal and external pressures. Thus, we welcome a reform that would make a step forward by increasing the sense of ownership and developing the European identity through fostering the creation of European public goods.

Which principles should then be used to establish the EU added-value?

- ***The starting point is the Treaty – the principles of conferral, proportionality and subsidiarity, as defined in Art. 5.***

Thus the case for EU action is made when, by the scale and the effects of the proposed action, best results can be obtained at the EU level. Pelkmans (2006) proposes a test for subsidiarity, having the Treaty as a starting point. However, he admits that his test is a functional one and should be of use to policy-makers as a cost-benefit analysis rather than as a set of criteria, that would establish which actions should take place at the EU level.

- ***The interpretation of the Treaty conditions should be broad, and not reduced only to economic reasoning.***

The effects are not only about spillovers and economies of scale or scope. They are also about enforcing cohesion in the Union, developing the European identity and strengthening its position in the outside world. One should not forget that the European project was implemented particularly because the Member States alone could not adequately deal with various challenges. In the 1950s these challenges related to achieving peace and re-building Europe. In the 21st century they relate, principally, to coping with globalisation pressures in a successful way. Those who think that solely Member State coordination can solve these issues see, in our opinion, only one side of the story. Coordination among nations does not ensure sufficient commitment and European nations, on their own, are often not strong enough to perform individually at the global level. The European Union must act more united and develop synergies, and must act in a timely fashion. European public goods are those that help Europe better tackle inner and outer challenges. They are of a wide variety and range from joint R&D projects, centres of scientific excellence throughout the Union, and skilled labour force to a socially, economically and territorially cohesive Europe which can better perform at the world scale; from good quality and well managed agricultural assets, such as soil and water, to more numerous and environmental friendly energy sources, and to actions that support progress of the developing countries and crisis management around world. These in turn can reduce threats posed by migration and terrorism in Europe and help dealing with global governance.

4.1.2. Which policies provide European public goods?

- ***EU policies provide European public goods when they respond to challenges that affect the Union as a whole.***

If possible and where necessary, policy objectives should be adjusted and all the instruments available for the Union should be considered when designing EU level interventions. This section addresses the way in which EU policies can tackle challenges and the role that financial assistance should have in the current context.

There is little a future budget reform can do concerning policy objectives. These are already established by the Treaty. It is highly unlikely that there will be another Treaty reform in the near future. In consequence, should it not be possible to alter policy objectives, one should improve delivery mechanisms. All the policy-making instruments of the Union should be considered in order to assign the most appropriate instrument mix for every policy. It is well-known that the EU is a regulatory giant and a budgetary dwarf. Spending is just one of the three instruments it can use. The other two are legislation and guidelines. It is not always the case that an important policy objective can be reached solely through financial means, and should therefore be reflected in the budget. The obvious example is competition policy, which is one of the exclusive EU competences. Competition policy is implemented mainly by using the EU's regulatory power and benefits from reduced financial assistance. A similar case could be environmental protection. The budget should reflect those policy objectives that ask for financial intervention.

The exogenous and endogenous challenges highlighted earlier in this document pose specific challenges for every EU policy. On the one hand, there is broad consensus that the EU needs to improve its competitiveness and prevent the erosion of its position at the global level. There is also consensus that environmental protection and global warming are issues that cannot wait and immediate action is needed. On the other hand traditional policies are still important, particularly for the new Member States. The Cohesion Policy has undergone several changes and is increasingly focusing on Lisbon targets. The Common Agricultural Policy needs reform, but this reform does not mean it should be disposed off completely. These two policies, as well as competitiveness and the EU actions at the global level are examined below.

4.1.2.1. The Common Agricultural Policy

The mission for the Common Agricultural Policy is twofold. On the one hand, its objectives, as stated by the Treaty, should continue to be met by the future reform. On the other hand, CAP, as all EU policies, must be adapted to the challenges posed by globalisation and EU inner strains.

The global context is affecting agriculture dramatically. There is increasing pressure on the demand for agricultural products due to the formidable progress of Asian economies. This rise puts upward pressure on the price of basic commodities, including cereals.²⁰ Likewise, there is considerable pressure on food supply due to the side-effects of global warming on agricultural plots and sources of water.

Both supply and demand side dynamics on food world markets would reduce dramatically the need for agricultural subsidies in the Union. But, the impact of

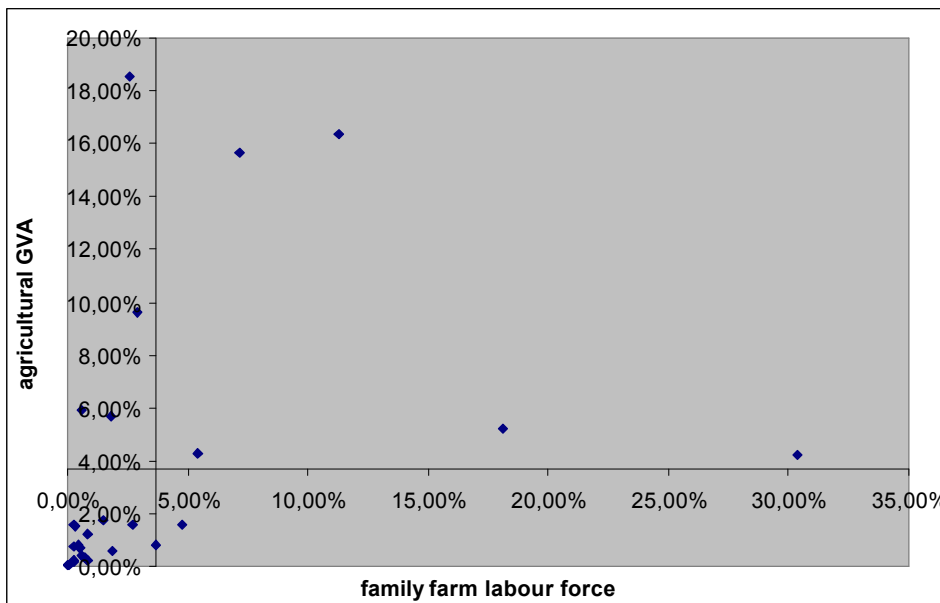
²⁰ The current international financial crisis, and an eventual recession in large areas of the world economy, may dampen this tendency for a while. But over the longer term the trends seems to be quite clear.

global dynamics on the efficiency of farms is largely differentiated and the CAP needs to take it into account, for reasons of social cohesion as well.

The CAP has to be re-examined against the background of the above mentioned dynamics. While the volume of subsidies should diminish decisively over a time frame the EU needs to develop intervention mechanisms to tackle risk and allow for crisis management. At the same time, the large variety of farm efficiency in the EU should be considered, in the short term at least. Most importantly, good land, as the main agricultural asset, should be better valued (measurements via narrowly constructed cost-benefit analyses are, arguably, misleading). Good quality land and water are European public goods of growing importance and should be managed accordingly, at both national and EU levels. The CAP should be designed in such a way that it be able to answer to the new challenges and resources should be targeted to this end.

An image of the EU complexity is illustrated by the very large structural differences among the EU members in the agricultural sector. Romania and Poland account for 48.5% of the total number of agricultural holdings in the EU27, and for 53.4% of the total number of small agricultural holdings (less than 5 ha). The CAP budget for these two countries, however, represents a much lower share in the total CAP expenditures (it will grow, nevertheless, up to 2013); the indicative ratio between the share in the CAP expenditures and the share in EU number of agricultural holdings is 1:10 for these countries, while the same ratio is 6:1 for Germany and 5:1 for the Great Britain. Italy and Spain also have a large share of EU agricultural holdings and of EU family farm labour force, but they also have an even larger share in EU agricultural gross value added (GVA) – which means that, in these countries, the agricultural labour force is more efficient, and the crops are oriented towards more value-added products.

Fig. 3: Labour force and value added, total agriculture, EU27=100



Source: based on Eurostat

Note: the axes cross at non-weighted EU27 average values.

France, Spain and Italy, which are among the top beneficiaries of the CAP, have also some of the highest shares of agricultural GVA in total agricultural GVA of EU27. This might be interpreted as the result of long-time support through CAP – something that is now questioned for some of the new Member States, which would need this type of assistance. Romania and Poland are the likely candidates for more funds, but also Slovakia and Hungary have small land plots; about 90% of their agricultural holdings are less than 5 ha. Moreover, Greece, Italy and Portugal have a high share of agricultural holdings of less than 5 ha, with ceilings above 70% of total in each case. All these countries would be in fact exposed to severe losses if the decoupled direct aids system is abandoned or if agricultural financing is severely reduced.

Previous reforms attempted to reduce market distortion mechanisms which were entailed by the implementation of the CAP; however their results are questionable. Regarding the assessment of the 2003 reform, Roberts and Gunning-Trant (2007) conclude that moving toward single farm payments is likely to result in less distorted markets for agricultural products, but that there is still a large use of market distorting forms of support (tariffs, quotas, export subsidies) and that the decoupled 'payments could maintain established distortions to production patterns'. The authors identify at least two reasons for this: expectations (farmers believe they are expected to continue production, and they also expect that a review of the CAP might change the emphasis again on production), and the cost of transfer (from a subsidised product to a non-subsidised one). Hennessy and Thorne (2005), based on survey results in Ireland, hold that a considerable number of farmers would opt for using their decoupled payments in order to subsidise unprofitable production.

There are two clearly identified problems in the current framework of CAP with the distribution of direct payments:

- ***The first problem is that the distribution is questionable from the point of view of social cohesion – as the Commission stressed it out on a number of occasions (European Commission, 2007).***

In EU-15, in 2005, 50% of beneficiaries received only 3% of total direct aids, while 2% of beneficiaries received 30% of total direct aids. In the ten new Member States that joined the Union in 2005 (NMS-10), 93.1% of beneficiaries received 39% of total direct aids in 2005 (less than 1250 euro per beneficiary farm), and 1.3% of beneficiaries received 45% of total direct aids. The higher share of beneficiaries receiving minimum amounts in NMS-10 reflects the predominance of small farms in the region. But the problem of highly unfair distribution is valid all around the European Union, in the new states and in the old states as well.

- ***The second problem is that the distribution of direct payments is suboptimal, given their stated objectives.***

- ***The answer to both problems, however, is not the further decoupling, because decoupling does not seem to work very well within the current structure of distribution of direct aids.***

Since the largest farms get most money, and since the largest farms also have the largest production potential, we could in fact expect that decoupling leads to the same result – subsidising production, mainly for the large farms. The solution is, arguably, neither reducing the support level while overall payments to big farms increase, nor increasing the amount of land per farmer to qualify for direct aid (both proposals are presented on the consultation’s website²¹) – as either of these proposals would only increase the inequality of payments’ distribution. On the other hand, the new situation on world markets should lead to a reassessment of direct payments mechanisms. For the reduction of the need for agricultural subsidies should be mirrored in how much direct payments presumably efficient large farms do get.

The payments for market interventions and direct aids are foreseen to decrease by 5.74% between 2007 and 2013²². And the new world situation on food markets would further highlight the rationale for reducing the volume of needed direct payments. However, the persistent disequilibria between the two pillars of the CAP, the beneficiary countries, and the beneficiary citizens²³, on the one hand and, on the other hand, the remaining significant market distortions induced by the CAP, require a reform of the CAP, which would lead to a reconsideration of the different realities in the Member States and of their agricultural assets, which are significant for the years to come.

The Treaty (Art. 33 TFEU) sets five objectives for the CAP: to increase agricultural productivity by developing technical progress, to ensure a good quality of life for the agricultural population, to stabilise markets, to guarantee the security of supply, and to ensure reasonable prices for food products. The CAP reform should not abdicate from these objectives; but it should better ensure that these objectives are clearly identified when resources are allocated.

There is no one way street for reform; and we should not take for granted that a reform means necessarily a severe cut in expenditures, in a short run There is also a moral implication to it: if, let’s assume, the CAP is abandoned altogether, or funds are cut across the board, or funds are redirected only based on performance, then the efficiency gaps between new Member States and other EU members (which benefited from the CAP for 40 years) will become of a chronic nature. There are several issues that need to be considered when deciding over CAP reform.

- ***First, farmers are a particular category of the society; many of them have been increasingly threatened by globalisation side-effects. A new “ballgame” on world food markets does not automatically change the lot of small farms.***

²¹ http://ec.europa.eu/agriculture/healthcheck/index_en.htm

²² According to the Interinstitutional Agreement of 2006

²³ See also Boulanger (2007)

In the new Member States agricultural land plots are severely fragmented. The re-conversion of agricultural labour force requires high investments and training programmes. An immediate side-effect of non-conversion will be migration to urban areas, or abroad, unless appropriate alternatives for rural development are designed. Here too, the new Member States have to face a greater challenge due to higher proportions of farmers in the total active labour force and infrastructure shortcomings.

There may be a trade-off between subsidising agriculture and accepting emigration²⁴ in countries where the GDP/cap is low and one could assume that maintaining CAP could diminish the propensity to migrate. Less money to agriculture may translate, in the poorer EU states, into higher incentives to leave for sources of higher income (and the propensity for migration abroad is higher than the propensity for migration within the same country). Furthermore, as national governments in the transition economies were generally unable to finance agriculture adequately, the CAP transfers may provide the incentive for some migrant workers to return at home, in the rural areas. It is fair to say, however, that the propensity to migrate is mostly due to high wage differentials between East and West and it is not up to the CAP to solve this issue.

- ***Second, despite trade liberalisation, the European production capacity of food must be valued and used so that the dependence on external sources of food supply should not become excessive.***

This is necessary, particularly in the case of imports from countries where veterinary and hygiene standards are not always fulfilled, and eventual pandemics could have serious effects on food supply in Europe. The supplies on the European food market should be ensured where possible from internal sources.

- ***Third, when addressing the reform of the CAP, one should keep in mind that there are other sectors and policies related to the CAP, which will be implicitly affected by the reform.***

Environment, food safety, rural economy, competitiveness and trade are usually referred to in connection with the CAP²⁵. These issues are largely addressed by the CAP itself: cross-compliance requirement helps protecting the environment; rural development is implied by the 2nd pillar of the CAP, while trade distortions have been diminished (at least in principle) by downsizing the intervention mechanisms in agricultural markets²⁶. Therefore, the CAP reform should

²⁴ For example, half of the Romanian emigration to EU between 2002-2006 (49%) comes from the rural area – see Sandu (2007).

²⁵ See DG Internal Policies of the Union, Policy Department on Budgetary Affairs (2007), “The EU Added Value of Agricultural Expenditure – From Market to Multifunctionality – Gathering Criticism and Success Stories of the CAP”, Brussels

²⁶ Gros and Micosi (2005) say that the CAP, by pushing relative prices and incomes in favour of agriculture, discourages investment in industry and services. Moreover, they say that the new member states have a much larger potential in the latter sectors, and should therefore be less interested in supporting the CAP. Their assertion, however, is not substantiated by facts; on the contrary, the prices of production means grew faster than the prices of agricultural production, over the last 10 years.

account for the context of other EU policies which might be affected. Direct cost-based analysis, as it is now suggested²⁷, is necessary, but it does not suffice to understand and analyse the CAP efficiency; opportunity costs should also be taken into consideration.

- ***Fourth, the question is how agricultural assets are defined in the 21st century, and which of these are European public goods.***

Assets such as soil and water have increasing importance in the context of climate change. The preservation of the agricultural habitats should be a priority of CAP, so should be the good management of fertile soils. An excessive reduction of farming activities would lead to a considerable reduction in the number of animals in Europe and to a loss in soil quality. Encouraging the production and availability of organic and healthy food products is a must. The increase of public health problems due to diabetes, coronary heart diseases and obesity, particularly among children, as a result of bad alimentation is worrying. It is important for Europe to have a healthy population in the context of speeding up economic growth, ageing population, and pressures of reform on the social welfare systems. Energy security is an issue that touches upon agriculture too, given the possibility of developing biofuel crops, and wind powered stations, where landscape conditions allow.

- ***In consequence, a reform of the CAP should focus on a redistribution of expenditures within the CAP, possibly co-financed with the Member States, and improve the targeting of measures.***
- ***In the context of globalisation challenges and the necessity to re-orientate and develop the skills of the population occupied in agriculture, more money should be allocated to the second pillar of CAP, focused on rural development.***

The new Member States in particular need to modernise agriculture, to develop rural infrastructure and diversify rural activities. Most of the resources should be redistributed from the reduced (or totally cut) payments for large farms, which represent the bulk of the financial resources allocated from CAP.

- ***The sums allocated for the income-support objective for farms less than 5 ha should continue as long as job alternatives are not available, while the sums allocated to large farms should be phased-out in accordance with the dynamics on world food markets.***

Only by doing this an effective decoupling of direct payments from production could be achieved. In this context, we agree with the idea²⁸ that farms with large turnovers should be excluded from direct payments (except for emergency situations, maybe). In this regard, our proposal is bolder than the current

²⁷ Idem 25.

²⁸ Idem 25.

modulation system proposed, which envisages, by 2013, marginal cuts for large farms and no increases for small farms.

- ***Targeting can be improved by moving from multifunctional purposes to a clear distinction.***

A part of direct aids should be allocated to income-support for farms less than 5 ha, possibly co-financed with the Member States. The other part of direct aids should be allocated for improving the cross-compliance of standards, soil and water management, and preservation of agricultural habitats.

It is important, however, to agree on the direction of the reform. We believe that, as far as the CAP reform is concerned, the liberalisation of agricultural markets can be achieved for those who are able to face it; that is mainly large farms. At the same time, the reform should focus on the redistribution of expenditures within the CAP, and on an improved targeting of the measures. As indicated above, there are essential European public goods, which should be managed at the European level through an equilibrated instrument mix. This analysis focused on the role of financial assistance in agriculture, but legislative measures and guidelines should also be considered.

4.1.2.2 The Cohesion Policy

The Cohesion Policy is challenged by the high expectations stakeholders have from it to tackle various needs in Europe, by the threat of 're-nationalisation' , and by what we think is misdirected policy analysis, by claiming that the policy is responsible for re-location. There have been claims in previous negotiation rounds that Cohesion Policy does not deliver at the European level; and that particularly in the case of wealthier Member States, national governments could tackle regional disparities on their own. There have also been claims that Cohesion Policy favours re-location by simply transferring wealth from West to East, rather than reducing the gaps of development and advance cohesion among EU regions. The recent decision by Nokia to close down a factory in Germany and to open a new one in Romania was interpreted by some EU politicians as a Cohesion Policy side-effect. The policy was accused of encouraging re-location rather than reducing the development gaps between European regions and creating new jobs²⁹. In our opinion this is a misdirected policy analysis as re-location is a globalisation effect, which takes place all over the world. The issue is not to avoid re-location within the EU. It is much more important to avoid re-location taking place from the EU to third countries, to the extent this possible.

²⁹ See Schui, H. (2008)

This section addresses Cohesion Policy by first assessing its current situation, second, by identifying the problems it should tackle and its added-value and third, by proposing some direct measures to improve its impact.

The challenge to manage EU complexity could not be better reflected than in the case of Cohesion Policy. The shape of the policy itself is a result of conflicting paradigms materialised in negotiation rounds carried out over the years between sympathisers of neoliberal capitalism and those favouring a regulated approach (Hooghe, 1998). The debates between the Friends of Cohesion and the Cambridge Circus, the two informal groups of Member States in Cohesion Policy negotiations, always concerned the size of the policy budget, its redistribution function, and its focus on traditional objectives such as infrastructure, on the one hand, and added-value, sound financial management, competitiveness, and absorption capacity, on the other.

Cohesion Policy is often thought to be a 'pork barrel' policy (De Rynck and McAleavey, 2001). It targets numerous measures within its broadly defined objectives and additional provisions for several Member States with *special status*, in order to allow every Member State to benefit from it. Although these political implications are not contested, globalisation side-effects cause problems across Europe. The Union is varied and disparities materialise in different ways across the regions and Member States, demanding different types of interventions. Consequently, issues are raised questioning the impact and added value of the European Cohesion Policy.

- ***The added-value of Cohesion Policy is visible and can be improved.***

Let us approach Cohesion Policy, going back to the idea of spillovers and 'the scale and effects of the EU action' mentioned by Art. 5 in the Treaty. There have been numerous attempts to assess the impact of the Structural and Cohesion Funds (SCF)³⁰. Most indicate that convergence was improved, particularly in the case of Objective 1 regions (those with a GDP/cap of less than 75% of EU average). With the exception of the regularly cohesion reports published by the European Commission, which tend to be more optimistic, convergence was hard to prove in the case of regions, other than those under Objective 1. Nonetheless, there are several limitations to this type of evaluations that should be considered.

First, providing that these studies managed to isolate the impact of SCF from other factors and their results are pertinent, is the lack of real convergence in Objective 2 regions, for example, a result of lack of added value or is it a result of few resources allocated at the EU level, which do not allow for a stronger impact? One may recall that Objective 1 regions, where some convergence was reached, have always received more than two thirds of Cohesion Policy allocations, and the EU involvement was greater, providing over 75% of the total assistance and having more clout in the management and targeting of the funds in these areas. On the contrary, the Objective 2 regions were allocated

³⁰ See for example Bachtler and Taylor (2003), Begg (2004), Boldrin and Canova (2001), Bradley and Morgenroth (2004)

considerably less funds (currently they benefit from 16% of the total allocations), which were implemented in a less coordinated way. Thus the question of impact and added-value should not be isolated from that of resources and implementation approach. In our opinion, claims of re-nationalisation are not justified. In fact, it seems to be the case that added-value can be seen, where EU intervention was greater.

Second, assessing real convergence does not mean assessing overall the impact of Cohesion Policy. The latter does not concern only economic cohesion, but also social and territorial cohesion. Added-value should have a broader definition in order to try to capture these aspects too. For instance, studies³¹ that considered other variables besides economic indicators found positive results. These variables included the positive effects of cross-border cooperation, the exchange of knowledge and best practices, and the effects that Cohesion Policy has on the implementation of other national policies with which it interacts. It is noteworthy that social and territorial cohesion is difficult to evaluate empirically. Like economic cohesion, social and territorial cohesion is reached in the long-term. A simple evaluation of a Financial Perspective span cannot lead to conclusive results. Furthermore, the Eastern Enlargement has just taken place. The new Member States are still in a learning process concerning the use and the development of their absorption capacity.

Third, there are differences in performance in the EU, which are embedded in the national policy-making context, rather than in the capacity of SCF to deliver results. There are countries and regions that have progressed rapidly in terms of living standards and productivity, while others continue to lag behind in spite of benefiting from substantial transfers. What has made the difference between the two sets of SCF beneficiaries? Evidence indicates that there is a broad array of factors explaining the divergence in performance. These can be grouped into three major sets. The first set reflects the limited success in fully integrating national development plans, the umbrella for the SCF deployment, into the country development agenda. The second set has to do with the capacity to plan at strategic level and develop a coherent policy framework, backed by a solid budget formulation and execution process. A third set of factors reflects the poor administrative capacity in the beneficiary institutions, associated sometimes with the initial conditions.

Some would argue in this case that the best approach is a concentration of Cohesion Policy assistance towards those who did not manage to make the most of it previously due to the kind of shortcomings indicated above and to the less developed Member States who are likely to face these difficulties in the future. For the successful cases, re-nationalisation would be the right option. A policy targeted only at the poorer Member States of the Union would reinforce a sense of a divide between the rich and the poor; it would stress further the case for simple financial transfers and bring more dissatisfaction for western European citizens. It would contravene to the very purpose of the policy, which is to foster cohesion in Europe and not to divide it. Furthermore, globalisation brings challenges that can and should be tackled only together, such as re-

³¹ See for example: Bachtler and Taylor (2003)

location effects, increasing the flexibility of the European labour force, and tackling migration within the EU. Besides building infrastructure, Cohesion Policy facilitates changes of best practices and speeds up the circulation of knowledge, which are essential for fostering growth.

The Treaty (Art. 158, the Reform Treaty) sets a clear objective for Cohesion Policy: to reduce the gaps of development between European regions, in order to promote the Union's 'overall harmonious development'. According to the Treaty, this can be achieved through economic, social and territorial cohesion and solidarity among Member States. Cohesion Policy has proven a great capacity to adapt to new challenges over time in order to answer to its objectives. Currently, a part of its expenditure is allocated to Lisbon Strategy objectives. The second objective of the Cohesion Policy, Regional competitiveness for growth and employment, allocates three quarters of its ceiling to this purpose, and a proportion of 60% of the sums allocated to the Convergence objective in the EU 15 areas are earmarked for Lisbon Strategy priorities. Nonetheless, most of the areas eligible for the Convergence objective are in the new Member States. These areas are still in need of traditional Cohesion Policy actions, such as infrastructure networks in order to connect better with the poles of development in Europe. Actions of this kind are not old fashioned. The purpose of Cohesion Policy is therefore primarily to reduce gaps of development and if this can help implement the Lisbon Agenda so much the better. One agrees that globalisation presses for a faster economic growth in Europe and increased competitiveness and Cohesion Policy should help tackling these issues too. However, investing in R&D is not the only way. Regions, which lack basic infrastructure and institutional capacities, will not be able to become competitive unless their underdevelopment related handicaps are tackled first.

- ***It is our opinion that the budget allocation for Cohesion Policy should be maintained or even increased.***

Its current structure is, in our view, appropriate, although the former definition of Objective 2, targeted at industrial reconversion might have better served reaching cohesion all over the Union. However, given the current global context and the need to support the Lisbon objectives, the three policy objectives addressing convergence, regional competitiveness, and territorial cooperation are well designed and resources are proportionately allocated. The objectives capture at the same time the need for traditional structural investments, the need for fulfilling the Lisbon Agenda objectives, and the need for territorial cooperation. Nonetheless, there is much scope for improving the implementation of the policy, and in particular for developing the absorption capacity of the Member States that joined the Union after 2004 and need to speed-up their progress in order to catch up with the most developed areas in the EU.

- ***Our view is that there is a need to focus on results more than in the past.***

In turn, this requires a more pro-active stance of the EU institutions, the national governments and the regions vis-à-vis the efficient use of the SCF, including the establishment of solid and performance oriented monitoring and evaluation systems at all levels. To achieve this, a review of the allocation of responsibilities between the EU, national and regional institutions in the management of the SCF might be warranted. Enhancing the institutional capacity of the SCF beneficiaries, both at local and central levels, to design and implement projects should **be** a priority.

The resources allocated to the Structural and Cohesion Funds have constantly increased from around 17.2% in 1988 to an estimated 35.7% in 2013 of the EU budget. There are countries and regions that have made progress in becoming more competitive and there are others where progress has been limited at best. Similarly, there are countries and regions that are catching up with the frontrunners in terms of incomes, while others seem to be trapped, in spite of substantial funding support from both the SCFs and national budgets. Concomitant with the increase in SCF resources, the flexibility of their use has been substantially enhanced, decision making decentralised and more of the funds go towards boosting competitiveness, growth and jobs. Evidence suggests that challenges manifest along two dimensions: a) generic problems, that have to do with meeting the development objectives against which the SCF are being deployed; and b) specific problems, that have to do more with programme implementation.

Against this background of mixed outcomes, two questions appear to demand priority answers: a) are there tensions between boosting competitiveness and the redistribution of resources that affect the performance of the SCF? and b) is enhanced flexibility in allocation, which not only puts the national governments in the driving seat in terms of deciding where resources go, but also gives practically unlimited choices to them to direct the funds, a problem rather than a solution? Are implementation capacity constraints undermining the very purpose of enhanced flexibility and decentralisation of decision-making? Some lessons, which illustrate these tensions, are drawn below on the basis of implementation experiences, including some from the new Central and Eastern European members.

- ***Improvements in the allocation efficiency and effectiveness of the SCF require both a better alignment of the national development plans with the EU policy priorities, and a better integration of the EU-wide strategic policy agenda into national development programs.***

Experience suggests that countries where the national policy framework has placed global competitiveness at forefront, within an EU context, such as Ireland and Spain, have been most successful in mobilising SCF for development. A stable macroeconomic environment, an outward-oriented productivity and competitiveness driven industrial strategy, within the framework

of the *acquis*, important improvements in human capital and physical infrastructure, competition, market liberalisation and regulatory reform and, critically, improvements in governance appear to have been prerequisites for a successful deployment of SCF. In those countries the SCF not only have become instruments for attaining national development objectives, but have also shaped the whole resource allocation framework, including the prioritisation and expenditure management framework. Noticeably, this happened against a background of not-so-clearly-defined EU-wide policy agenda at the time, prior to Lisbon Agenda's beginning to take shape.

- ***The Cohesion Policy context could therefore serve as a framework for anchoring national policy-making, especially in the new Member States.***

It is generally accepted that most of the priority reforms needed, many regarding the functioning of the public sector, have to occur within the member states themselves, rather than at the EU level. The experience of Ireland and Spain, for example, suggests that the EU SCFs processes have 'exported' and enhanced oversight, benchmarking and knowledge sharing, which have shaped, to different degrees, public sector processes in the beneficiary countries. The introduction of ex-ante program analyses, multi-annual planning and budgeting for SCFs, and the system of ex-post evaluation were subsequently extended in Ireland to the whole public sector, with remarkable results in terms of increasing the efficiency of public spending. We argue therefore that, at least in the context of the new members, the SCFs should have a strong national development dimension, in a comprehensive sense, given the large income and productivity gap relative to the old members. In other words, the SCFs should help the new members exploit the opportunities offered by the EU common market by playing the role of an all-inclusive, integrative framework for national development.

- ***The SCF represent, in our opinion, an important instrument for accelerating real convergence within Europe, but the need to improve the allocation and efficiency of public spending, in general, remains an outstanding and sizeable challenge for many members.***

The degree of success in achieving convergence varies considerably across countries and regions in spite of substantial SCF funding support, of which some benefited for long periods. Important public resources, including SCF, still go to unproductive policy actions, or what is even worse, are misused in a fraudulent way. There is significant scope for enhancing the quality of public investment in infrastructure and human capital. Evidence points to the fact that the countries with better state of governance seem to spend more efficiently and effectively.

- ***At national level, there is a need to improve consistency and clarify the strategic direction across policy products and processes.***

Policy products include government programs, plans for the implementation of the *acquis*, convergence plans, reform plans, or national development plans (NDP). These various strategic documents often derive from distinct processes involving different role players and with dissimilar purposes, some political, some focused on deepening EU integration and some focused on SCF access. In reality, not all are true strategic government-wide frameworks that give unequivocal direction to people and the public sector about what the government intends to achieve. While the enhanced flexibility in the allocation of the SCF across sectors to better respond to priorities is welcome, parallelisms in planning prevent reaping the full benefits pursued.

- ***Vulnerabilities at the strategic planning stage, which generally takes place at the centre of the government, bringing decision-making into the nexus of politics and administration, manifest primarily in two areas.***

The first of these is the absence or the insufficient development of a broad government-wide policy framework that should define government goals clearly and allow the articulation of more detailed central and local government programs, roles and responsibilities. The second area relates to basic policy-making capacity constraints in sectors and line ministries, and the specification of medium-term expenditure preparation ceilings for government budget entities. This should take place for line ministries and other centres of government agencies and for local government entities. It entails revenue forecasting capacity matched with realistic and prioritised sectoral policy planning, and the decision to use such information to discipline budget preparation. Having such pieces in place would ensure a linkage between policy thinking and government fiscal realities. Without this tie, policy products and budget proposals often become undisciplined ‘wish lists’ that are difficult to connect to the resources framework.

- ***Integrating policy, planning and budgeting across the government is therefore central to sustaining growth and achieving the strategic objectives of convergence.***

Institutional, policy and process weaknesses of the public financial management systems are central obstacles to strengthening aggregate fiscal discipline, improving the effectiveness of public resources allocation and aligning the resources with the strategic priorities of the countries. This affects also the absorption of the SCF. Evidence shows that the relationship between policy, planning and budgeting is one of the most important factors contributing to poor budgeting outcomes at macro, strategic and operational levels in the Member States. Key limitations come from the fragmentation of the public finance management system and vulnerabilities visible at all stages of the public expenditure management cycle.

- ***More emphasis should be paid to developing medium term expenditure frameworks (MTEF) and budgets on programs, to which the SCF should be an integral part and treated similarly to other financial resources.***

Faced with conflicting objectives and constrained resources, Member States attempted to establish MTEF as a means of balancing the aggregate affordable resources with the policy priorities of the countries. However, rarely have the MTEF achieved their intended objectives of enhancing the clarity of policy objectives, improving the predictability in budget allocations, the comprehensiveness of coverage and transparency in use of resources. Instead, the MTEF are more of an annual exercise, projecting revenues and expenditures several years ahead, rather than a multi-year budgeting initiative to guide annual budgets, with limited substantive multi-year programming content. The MTEF are often substantially altered from year to year and lack a thorough connection with other processes, such as the NDP. In some countries, budgets are organised by programme after the line-item allocations are decided upon, indicating the use of programmatic concepts as an ex-post rather than an ex-ante tool to ensure policy orientation in allocations.

- ***Improving absorption and effectiveness of SCF should also target the reform of the annual budget cycle in some members.***

Frequent shortcomings include insufficient strategic and policy guidance for the allocation of funds, weak linkages between funding and performance, frequent budget rectifications reallocating important resources within the year, delays in the effective start of the budget cycle, limited cooperation between finance departments and credit holders both in the formulation and execution of the budget. Deficiencies are sometimes augmented by an inadequate macroeconomic and revenue analysis and forecasting framework.

- ***There is a need to pay significantly more attention to upgrading the administrative capacity of SCF beneficiaries, especially at sub-national level, and of managing authorities.***

The capacity to design and implement complex projects in order to access SCF is often limited. As a consequence, SCF absorption is low and resources sometimes do not commensurate with outcomes. This is particularly evident in the first years after being granted access to the SCF and in the case of the poorest local governments, which need these resources the most. This situation is occurring in spite of the fact that the new EU members, for example, have received for long periods of time substantial pre-accession funding and expertise support for capacity building. This support has been internalised by the public institutions only to a limited extent, as it was the case with the pre-accession funds (PHARE, ISPA, SAPARD) and occurred mostly outside the national budget process. As a result, the interaction between those involved in the management of the pre-accession funds and the budget planning and policy departments is traditionally limited. Consequently, the net inflows of funds to the Member States, excluding CAP direct payments, (SCF gross inflows minus Member State contributions to the EU budget) are small and often times negative in the early years of membership.

- ***The economic rate of return of SCF projects should be given more prominence, which in turn requires more focus on developing project design skills.***

While there have been improvements in clarifying and simplifying the SCF framework, including in what concerns the guidelines for project preparation, the standards remain high and the beneficiaries often do not have the skills to meet them fully in the project design stage. As a result, often beneficiaries cut corners and run into problems. A frequent problem is that absorption and impact are often decoupled, and the internal rate of return of the projects does not ensure their long term sustainability ('building cathedrals in the desert'). There are numerous examples where current spending resulting from project completion was not taken into account. This introduced substantial rigidity in national and local budgets, squeezing capital spending. Identifying ways to better leverage private sector skills should improve the quality of the projects both in terms of SCF absorption and developmental impact.

- ***In order to improve the linkages between programs performance and resources allocated from the SCF, there is a need to strengthen monitoring and evaluation (M&E) systems.***

These systems should assess in a comprehensive and timely manner the extent to which resources help in achieving the intended outcomes and feed-back into the policy framework for eventual corrections and reallocations. Experiences of some old members, such as Ireland, suggest that the effective use of M&E systems not only improves the overall absorption of the SCF, but it also allows for rapid redeployment of resources towards better uses. Appropriate incentives schemes, backed by performance indicators, to reward the better performers and sanction the laggards should be part of the M&E system, taking into account at the same time the institutional capacity of the beneficiaries. While the level of SCF absorption matters, it is even more important to make sure that resources go where the needs are and where their impact is maximised.

Unequivocal positions vis-a-vis these issues are probably not possible, given primarily the large disparities between Member States and regions in term of development and policy and institutional maturity, translating into a broad array of priorities at national and sub-national level. The stated objectives of the SCFs are broad, and the instruments increasingly flexible, allowing member countries to employ resources for a broad array of sectors and activities. This has clear and proven advantages. The downside is whether the funds are not rather too thinly spread in order to make a difference in terms of overarching outcomes.

In this context, a follow up strategic question vis-à-vis the SCF use is whether there is a need to better focus them, making a more clear distinction between competitiveness and redistribution. For example, the funds focusing on competitiveness could target a cross-cutting EU-wide set of policy priorities, in which case presumably the role of the EU institutions in allocating these resources should be enhanced, and the role of the member state appropriately

diminished. Equally, the funds targeting redistribution should focus on narrower, country specific set of issues, in which case more delegation should be given to the Member State and eventually to the beneficiary regions themselves. The EU action, in this situation, could focus on fostering exchange of views and best practices.

- ***To sum up, Cohesion Policy is one of the most important EU policies at the moment because it has the capacity and the potential to contribute to a cohesive development of the Union, with tools designed to manage the EU's socio-economic complexity.***

The policy is designed in such a way that serves to every Member State, however this reducing the impact of cohesion actions. There are also issues posed by the small absorption capacity, particularly in the new members. A balance must be found between concentrating the funds and ensuring that the problems posed by regions lagging behind all across the Union are tackled. In our view, a clearer distinction between competitiveness and redistribution could be a solution to this dilemma. Improving programming and policy planning, as suggested above are too among the ways to improve absorption and maximise the SCF's impact.

4.1.2.3 Competitiveness (Lisbon Agenda)

EU spending on R&D and competitiveness is consistent with the higher emphasis put on knowledge and innovation by the Lisbon Agenda. The Competitiveness and Innovation Framework Programme 2007-2013 and the recently established 'Lead market initiative' are useful tools to foster competitiveness, promote innovation and unlock market potential. However, according to the European Commission (2004), the Research Framework Programme was able to finance just about half of the 'very high standards' projects proposed, due to limited funding. The EU currently spends on average, on R&D, considerably less than the US or Japan. The Scandinavian Member States are the only ones that invest over 3% GDP in R&D, and have greatly improved their economic performance as a result; but this also entailed deep economic and social security system reform and a high proportion in the society of university graduates. Furthermore, the Scandinavian countries have carried out a successful industrial policies strongly, which relied on public-private partnerships. These are lessons that must be applied all over Europe when dealing with R&D investments.

The R&D and competitiveness policy matters because companies do not innovate in isolation, but within a system, and the particularities of this system and of its instruments are essential to the innovation performance (Smits and Kuhlmann, 2004).³²

³² The refocus of EU budget and the need for more efficient mechanisms concentrating on the EU's role as a facilitator were stressed out by the Sapir Report (2003).

- ***A flaw of the public expenditures on R&D, both at national and EU level, is that they do not provide sufficient incentives for private R&D.***

The EU performance has been very diverse among its members; but on average it has been surpassed by the US and some Asian countries. A recent study from JRC (2008)³³ illustrates that even at the company level, the business expenditure for R&D in the EU are much lower than the business expenditure on R&D of the US companies. For instance, in the ITC industry, the R&D intensity (calculated as the share of R&D expenditures in value added) is 6.2% in EU25, compared to 10.4% in the US, not to mention that the size of the ICT sector, as a share in GDP, is higher in the US than in the EU25 (6.2%, respectively 5%).

At national level, the ratio between public and private R&D has remained around 3:4 since the Lisbon Agenda was launched, while the target set by the Lisbon Agenda was a ratio of 1:2, within the framework of 3% of GDP overall R&D expenditures. At the EU level, much of the EU funds for R&D (the Framework Programmes in particular) go to publicly funded research institutes and universities. Furthermore, there is a certain (informal) bias in favour of large countries; quite a few research institutes and universities from the new Member States are project leaders in EU funded projects. One reason for this could be the lack of financial resources and experience; another reason (see Wynn and Nunez Ferrer (2007)) could be the use of R&D as a political tool to compensate for net contributions on other budgetary items.

We would like to draw attention on three aspects linked to the future of R&D and competitiveness policy of the EU.

- ***First, the EU funding for R&D and competitiveness does provide value for money. Impact assessments in general prove a high return of R&D investments, but there is substantial scope for greater efficiency.***

Alfonso and Gonzales Alegre (2008) analyse the impact of budgetary components on economic growth, at the EU level. Arguably, R&D expenditure is 'public expenditure as a separate input in the production function', as R&D expenditure influences technology, and the latter influences total factor productivity, which has a positive impact on GDP growth, and on total factor productivity growth. The expenditure targeted at enhancing competitiveness, especially those for SMEs support is a 'capital-enhancing' type of expenditure. It is a subsidy for private capital, which also has a positive impact on GDP growth but no impact on total factor productivity growth.

EU expenditure on R&D and competitiveness meet the criteria of being a public good (to the extent knowledge is free) and bringing in value added. R&D expenditure is in conformity with the subsidiarity, additionality and value for

³³ Lindmark et al (2008).

money principles, while having a mixed performance on the proportionality principle (Wynn and Nunez Ferrer, (2007)).

An increase in the expenditure on competitiveness and R&D is strongly justified by the challenges that the Union has to face and is supported by the political will and public opinion. Consequently, regardless of the possible scenarios for the future EU budget, fostering an increase in R&D expenditure to reach the targeted 3% of EU GDP average will definitely be on the agenda.³⁴

- ***Second, there are more forms of R&D, more types of knowledge-based economies, and more types of competitiveness - depending on EU members' level of development. EU R&D expenditure should not relate exclusively to high value added R&D and high-end product innovation.***

R&D is taking the form of technology absorption, knowledge is taking the form of knowledge diffusion and innovation is taking the form of process innovation, especially in the new Member States. Supporting these forms of R&D and innovation aids the catching up process of the less developed economies in the EU, therefore increasing the value for money. For emerging economies, as it is the case with most Eastern and Central European Member States, the assimilation of new technologies is much more important and a premise for contributing to technological progress in the long run. Moreover, the absorption of new technologies and investments in R&D should be linked with further reforms in the educational system, and the promotion of science-based university studies, in order to provide the necessary human capital for increasing competitiveness and R&D, avoiding having graduates mostly in humanities.

- ***Third, the management and implementation of these funds is just as important as the amounts.***

Romania, for instance, has tripled the amount allocated to R&D in the last few years reaching a ceiling of 0.7% GDP. Nonetheless, attention must be paid to the efficiency of R&D investments.

Likewise, there is need to foster fundamental research in the EU. Initiatives, such as creating centres of scientific excellence should be supported, since they could slow down brain drain.³⁵

³⁴ Mrak et al (2007) propose four scenarios for the next EU budget (2014-2020), expenditure for R&D and competitiveness increases in all four of them: existing expenditure level scenario – competitiveness expenditure more than double in nominal terms (unless further enlargement); existing policies – same evolution for competitiveness expenditure; restrictive scenario – with a moderate growth of competitiveness expenditure; and community scenario – competitiveness expenditures more than triple, in the context of a large increase in EU budget overall.

³⁵ The Romanian Institute for Advanced Research (RIAS) is an idea which aims at using the expertise of worldclass experts who work now abroad. This would be a right approach for emerging economies and should be encouraged by the EU.

In our view, a number of problems should be addressed before an increase in financing is agreed upon: First, there is a problem of disproportionate allocation biased towards net contributors in compensation for other EU budget items; these funds should not act as a buffer. Second, funds should encourage more for applied research, with business/industrial applications. Third, there is an issue raised by biased access, as research institutes and universities which are financed on a permanent basis from national public budgets are more likely to win projects from EU funds, as they have larger annual budgets and more co-financing capacity. Fourth, the related bureaucratic procedures are very complicated, representing an entry barrier for new applicants. Finally, more training needs to be provided by EU institutions on how to absorb these funds, in each of the beneficiary countries.

The EU competitiveness and R&D policy has become one of the most important tools that can be used at the European level for fostering economic growth and helping the EU face globalisation challenges, and in particular the emergence of new economic powers at the world level. Consequently, R&D is one of the areas that require greater financing in the future. Nonetheless, it is important to spend money wisely. The complexity of the Union, especially the socio-economic variety among Member States demands for a differentiated approach. There are Member States, which can and should focus on innovation and there are Member States, which should focus as a first step on absorbing current high-level technologies. Also, investment in R&D must be correlated with other policies. Particular attention should be paid to education and the promotion of public-private partnerships.

4.1.2.4 The EU at the global level

- ***A better coordination between the Member States and the Commission and between the world donors could lead to more significant results in tackling issues in the developing world, without necessarily increasing financial assistance.***

The European Union is currently the largest world aid donor, covering approximately 55% of the global official development aid. The main instrument used for tackling poverty, combating illiteracy, hunger, discrimination against women, ensuring drinking water and environmental protection (also known as the Millennium Goals) in the developing areas, is the European Development Fund (EDF). The EDF is a separate instrument from the EU budget, with its own system of resources, management and programming, and covering for the 2008-2013 period 22682 million euro. Although the EU15 nations agreed to double the EU's development aid by 2015, there are still Member States that failed to increase their contributions. As argued earlier, when the external challenges of the Union were addressed, helping the developing world facing its problems reduces the likelihood of massive migrations to Europe. This is also important for implementing the external dimension of the Lisbon Strategy.

- ***Ensuring security within and for the European Union is a European public good. Member States should intensify dialogue concerning this issue and the EU budget should contribute to this end.***

Combating migration and ensuring harmonious growth in the EU are also linked with EU's ability to ensure that wars in the other parts of the world do not affect its development. The failure of the Member States to find a joint position on Kosovo, for instance, indicates that the EU is far from having a common voice on foreign affairs. Nonetheless, it is essential to be able to carry out at least peace keeping and crisis management missions, as those defined by the Petersberg tasks. Moreover, the introduction of the solidarity clause in the Lisbon Treaty calls for more efforts towards a common defence policy.

- ***In order to be a global actor, the European Union needs to be able to act coherently and fast at the world level. This implies the necessity of a common external policy which is financed by European resources.***

Common Foreign and Security Policy (CFSP) is not only about sending troops abroad. It means also managing energy policy, by diversifying supply sources and strengthening and developing energy and gas transport networks. There are many intentions voiced by Member States and private stakeholders to tackle these issues. Until now, Nabucco is the only project that really materialised such intentions. Nabucco should be implemented and should receive funding from the EU budget. It is noteworthy the great discrepancy between the importance of ensuring energy security and the small contribution that the EU budget makes to this end³⁶.

- ***The EU needs to better integrate energy policy in its external actions and to allocate more resources to ensuring energy security***

The EU needs a coherent energy strategy materialised in concrete projects designed at the European level, which are financed from the EU budget. Given the high dependence of the Union on external energy sources, the aim is to enhance energy security by optimal resource management. The EU budget must be one of the major tools used in this direction

³⁶ The EU budget finances only feasibility studies. The major costs are financed by the Member States and companies.

4.2 Own resources

The budget of the Union was based in the past only on an own resources system (custom duties, agricultural duties, sugar levies). These now account for less than 20% of the European revenues. The creation of the Single Market in 1986 led to a sudden increase of the European budget. This was sustained by GNI-based contributions, which now represent the main source of revenues. The Lisbon Treaty introduces provisions, which encourage the review and the reform of the own resources system, particularly the introduction of new budgetary resources. There are a series of principles and a few options for updating the own resources of the Union.

- ***As it stands the system could be sustainable and just. However, correction mechanisms have been designed to respond to and adjust imbalances triggered by the budget expenditure.***

The European Commission presents in the Consultation Paper a series of principles that budgetary resources should respect, acknowledging the fact that at the moment none of the EU financial resources fulfil all the criteria. Among these principles are: equity, efficiency, simplicity, visibility, financial autonomy, stability and sufficiency. It is hardly possible to define own resources that would fulfil all these.

- ***Key to a functional system is pragmatism. We need a system that works. Therefore it must be sufficient, stable, simple and equitable.***

It must be sufficient because all types of revenues should support on a constant basis at least the existing level of revenues. It must be stable in the sense that the revenues must be predictable. It must be simple, transparent and equitable. Correction mechanisms should be abolished and no special arrangements should be made for any Member State.

- ***A larger budget would be needed for the EU policies to be able to sensibly contribute to tackle challenges posed by globalisation, migration, global warming and security of energy supply, and the Union's inner complexity.***

All these new challenges cause new needs for the Europeans, which the EU should tackle together with the Member States. Nonetheless, the implementation of the European funds has quite often raised eyebrows in the public opinion. There have been numerous cases of mismanagement and fraud, which encouraged the spread of Euro-scepticism. In order for the EU tax payers to accept more integration, new taxes and a larger budget, they must see that their resources are used appropriately and for their own good. Therefore, more transparency, accuracy, and responsibility concerning the management of the European funds are a must and a pre-condition for enhancing the European identity and for allowing for a larger budget of the Union, which can provide for the appropriate tools to manage growing challenges.

- ***In consequence, at the moment there is no scope for introducing new taxes, and contributions to the EU budget should continue to be GNI based. In the long-term, however, the budget should be increased and new resources should be added to the already existing ones.***

Several types of taxes were already proposed as alternatives to GNI contributions³⁷. So far only VAT responds to sufficiency and stability criteria. Several other taxes on the provision of European public goods, such as taxes on pollution, corporate activities, energy consumption, and European Central Bank profits can be additional revenues to the EU budget in the future.

5. Implementation of new provisions

It is most likely that the review process initiated by the European Commission will lead to a reform of the EU budget. The agreement on the last Financial Perspectives was conditional on the budget review process. The net-payers are not willing to sustain a similar budget from 2014 onwards. Their weight in the budgetary decision-making process is unquestionable, and therefore the reform of the budget and EU policies looks inevitable in the near future.

- ***Regardless of the shape of the reform, new provisions should be implemented gradually, to allow for a smooth transition. Nonetheless, new challenges require the need to act in a timely fashion; hence a balance needs to be found between harmonious transition and fast adaptation to a changing context.***

Any sudden cuts and refocusing of financial assistance can trigger disequilibria. In addition, they would form a non-started approach. Assistance should be phased-out during the length of a Financial Perspective to allow those who loose assistance to re-orientate towards other activities. A similar length of time should be applied to phasing-in assistance in new areas. Previous experience with Structural Funds allocations proves that time is needed to explore new absorption capacities in order to avoid fund de-commitment.

- ***For increased accountability and better management, Financial Perspectives should have the same length as the mandates of the European Commission and the Parliament.***

This would allow every Commission College and Parliament to be part of the entire budget cycle: consultation, debate, proposal, negotiation, agreement and implementation. This is better than having a seven year span.

³⁷ Please see the European Parliament's Resolution of the 29th of March 2007 on the Future of European Union's Own Resources and W. Schüssel (2007)

- ***There should be more flexibility in the Financial Perspectives in order to allow the Union to better respond to new and unforeseen situations.***

Although we understand the reasoning behind establishing expenditure headings, one must also consider the need of adjusting financial intervention to the changing context. The budget must be able to rapidly respond to the Union's needs. Consequently, we propose either the possibility of transferring a certain proportion of funds between headings or creating a budget reserve (as all national budgets do have!).

Concluding remarks

This paper presents a view from a new Member State of the Union on how to approach the budget review, given the numerous challenges that Europe is confronted with. It first addresses the reasons behind the current situation of the EU budget. Then it tackles the exogenous and endogenous pressures affecting the Union and stressed some core principles that should guide the budgetary review and eventual reform. The expenditure side and the own resources of the budget are the focus of the fourth section of the paper which reviews main policy challenges, the added value of European public goods and the possibility of introducing new resources. The last section examines the implementation of the eventual new budgetary provisions.

The main exogenous challenges of the Union originate in globalisation effects. The EU must speed its economic growth in order to face increasing competition from newly emerging global powers. At the same time, the EU should be able to face increasing immigration by improving its approach towards the developing world and re-defining its protectionist policies. To this adds the necessity to ensure energy security and to tackle global warming. A major problem is the inability of the Union to maintain its welfare systems in a changing global environment.

Internally, the Union is strained by its growing complexity. It is increasingly difficult to design EU level policies given the discrepancies in economic development, policy views, national interests, and integration paradigms that characterise the Member States. Further enlargement and deepening of the integration process are commitments that must be fulfilled. Nonetheless, the functionality of the single market continues to pose problems and more needs to be done; knowledge should circulate freely. Finally, re-location within the Union is a major issue, which stirs dissatisfaction and rivalry among EU citizens and challenges the solidarity among the EU nations.

In this context, it is fundamental to re-design the EU budget, in order to finance European policies that are able to tackle these challenges in synergy with national policies, by providing European public goods. The added-value of the

EU action and the interpretation of the Treaty provisions in this direction should be broad, and not solely through economic lenses. Promoting solidarity, exchange of knowledge and best practices, improving national policy-making, and a stronger action of the Union at the global level are just among the few factors which bring added-value at the European level.

In what concerns agriculture, it is essential to consider, first, the impact of global warming and increased population on the supply and demand for agricultural products. Consequently, proper management of good quality soil and water should be a fundamental objective of the CAP. Second, the side-effects of the CAP over the last 40 years were the growth in the size of land plots and farms. The new Member States are characterised by small land plots and a high proportion of the occupied population in agriculture. The reform of the CAP should target the internalisation of these problems by, initially, securing income support for small farmers, and secondly and increasingly supporting the diversification of rural activities, and the modernisation and development of the rural infrastructure. These measures would allow for a fair treatment of those farmers who were not able to benefit from CAP, and also for developing the capacities for better managing the essential agricultural assets in the 21st century.

Cohesion Policy is of great importance for the Union's development because it has the capacity and the tools to improve economic, social and territorial cohesion. The issue with Cohesion Policy lies more with its implementation. There is a need to improve the absorption capacity and to better target and manage Structural and Cohesion Funds. This paper proposes some solutions in this direction.

Finally, there are several key observations that result from the paper. First, it is essential that the review of the budget is carried out with the purpose of bringing added-value at the European level. It should not serve only the interests of the net contributors or only those of the beneficiaries. It is true that it is highly difficult to find a way that reconciles all points of view. However, we all should have in mind the necessity to provide European public goods and to properly manage the complexity of the Union. For, despite conflicting views among Member States, a common denominator can be found in terms of overall/common gains that serve all Member States.

Second, the size of the budget is unlikely to fundamentally change in the near future, as a reform of the own resources, even if agreed upon, will take time to implement. Thus, it is essential to find equilibrium between having financial support for all the Union and concentrating it to the areas most in need. When deciding on financial support, the other two instruments of the Union should be constantly considered – legislation and guidelines. The budget should be assigned to the supply of those public goods that demand financial assistance.

Third, a mix of bottom-up and top-down approaches is necessary for budget implementation. The challenges faced by the Union require both overarching coordination and policy differentiation. Consequently, the national level of governance plays a salient role.

Fourth, the review and the reform of the EU budget should carefully consider the democratic deficit in the Union and its causes. The numerous cases of mismanagement and fraud concerning the European financial assistance and scandals which have involved EU officials³⁸, as well, have led to the emergence of mistrust in the EU and the promotion of Euro-scepticism. These hinder the further development of the integration process and the adoption and implementation of appropriately designed reforms to tackle the challenges of the 21st century. Increased transparency, more responsibility, and more functional systems of management and control are *a priori* conditions for a consistent budget reform.

Fifth, the EU budget can act only as a lever. It is unrealistic to expect a fundamental and rapid change. In view of the size and importance of the pressures linked to globalisation and complexity, and the need of an active response to change, it is essential that the national budgets and policies also adapt to the current context and act accordingly. Only through such an approach we can ensure that what we have reached so far through the process of integration is not lost.

³⁸ See the Santer Commission crisis or the current discussions concerning the misuse of assistance funds by some Members of the European Parliament.

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