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ANALYSIS

What are the concrete prospects for a rise in Community expenditure?

While the EU financial framework for 2007-2013 has only just come into force, many observers agree in considering that the Community budget is still too low. With the prospect of a "revision" of the financial framework planned by the European Council of December 2005 – the official kick-off for which should be in mid-2007 with the publication of a European Commission guideline document – this assertion deserves closer examination.

The denunciation of the Community budget's inadequacy (864 billion euros for the 2007-2013 period, i.e. nearly 1.05% of the EU's GDP) is most often based on the low financial investment observed, at Community level, in certain key sectors (particularly expenditure devoted to the Lisbon Strategy and Cohesion). It generally leads to figure-based proposals to increase that investment (2% of GDP, 3% of GDP, etc.) that are more political than technical in nature and rely on references to the central budgets of "federal" type unions (e.g. Canada, Switzerland or the United States) where it represents between 10% and 25% of global GDP. Nevertheless, such comparisons should be handled with caution, given the differences in political and constitutional environments that explain, in part, the budgetary divergences observed.

Within an unaltered political and legal framework, there are not many fields in which an increase in Community expenditure would seem most plausible in the medium term. In reality, therefore, the overall maintenance of the European budget at its current level is to be expected. In effect, it appears that:

- agricultural and cohesion expenditures are unlikely to increase in absolute value;
- the possible increase in expenditure devoted to the Lisbon Strategy and economic stabilisation will have a limited impact on the level of the Community budget;
- the possible rise in external and defence expenditure is more open, but would also have a very limited effect on the Community budget.

Agricultural and cohesion expenditures seem unlikely to increase

Although they should represent an average of 78% of Community expenditure between 2007 and 2013, agricultural and structural expenditures seem unlikely to increase in the medium to long term.

Community expenditure on agriculture should continue to fall in relative terms to reach less than 40% of Community expenditure in 2013 (i.e. 0.4% of GDP) as a result of three factors:

- the development of international trade negotiations, which could lead to a limitation of export subsidies;
- the erosion of Community political consensus: the self-sufficiency of European countries in food would seem to be a more controversial objective in the EU-27 than when the CAP was launched in the 1960s (on the basis of a Franco-German compromise);
- the changeover from production aid to producer aid instigated by the 2003 reform: if the latter has no direct effect in terms of distortion of competition, it could even be financed more easily at the national level.

Cohesion expenditure (35.6% of Community expenditure between 2007 and 2013, i.e. a little less than 0.4% of GDP) could, at first sight, retain an important position in a Union whose economic and social heterogeneousness has greatly increased. However, three factors should limit prospects of an increase:

- the low "absorption capacities" of the countries that benefit from it: based on experiences recorded in Spain, Greece, Ireland and Portugal, the European Council decided that the total annual amount received by each member state should not exceed 4% of its GDP, as they are not able to use it (insufficient number of projects, weak administrative and management capacity, etc.). The cohesion expenditures the 12 countries that recently joined the EU benefited from were set within this limit (on average, about 3.5% of their GDP). Everything would seem to suggest that the levels of subsidy possible future new member states could benefit from (including Turkey) would also fall below this limit;

- in this context, the recent membership of 12 countries that are less prosperous than the Community average has a downward effect on the calculation of EU cohesion expenditure: in fact, it creates expenditure that is automatically lower because it is intended for countries whose total GDP is equal to approximately 7% of the EU's GDP;
- the membership of countries that are less prosperous than the European average also leads to the exclusion of regions and areas that have become "statistically" richer than the European average from receiving cohesion expenditure (Corsica, the Belgian Hainaut province, etc.).

The increase in expenditure linked to the Lisbon Strategy does not necessarily lead to an overall rise in the Community budget.

Since the implementation of the Lisbon Strategy is one of the EU's political priorities, it gives rise to stronger and stronger demands for increased European expenditure in the sectors concerned (R&D, education/training, transport, etc.). For all that, the global impact of such an increase in Community budget would doubtless remain limited.

The analysis of the proposals formulated by the "Sapir Report"[1] helps size up the maximum impact that an increase in Community expenditure dedicated to the Lisbon Strategy would have on the level of the EU budget.

Table 1
Level of economic and social expenditure recommended by the Sapir Report

Expenditure	Percentage of EU GDP
Growth	0.45
R&D	0.25
Education and training	0.075
Infrastructures	0.125
Convergence	0.35
For new member states	0.2
For old member states	0.1
"Phasing out" for large regions	0.05
Restructuring	0.2
For displaced workers	0.05
For agricultural expenditure	0.10
Total expenditure	1.00

If the proposals of the Sapir Report were applied, the Community budget would in fact increase:

- by a little less than 0.4% of Community GDP, mainly because of the increase in expenditure to support "growth" (R&D, education and transport)[2];
- by 0.8% of GDP if the increase in expenditure to support growth was carried out without reducing agricultural expenditure (which would remain fixed at 0.4% of GDP instead of the 0.1% anticipated in the Sapir Report) and cohesion expenditure (which would be higher than about 0.1% of GDP).

A rise in public expenditure dedicated to the Lisbon Strategy could nevertheless be made without increasing the EU budget:

- first of all, because the increase in expenditure dedicated to the Lisbon Strategy could take effect with a virtually constant budget via the redeployment of expenditure between the different budget sections (e.g. from the CAP towards R&D) and within these sections (more than half the agricultural and structural expenditure already finances "Lisbon" measures[3]): this, indeed, is the working hypothesis accepted by the Sapir Report;
- next, because precompetitive expenditure, such as R&D and infrastructure expenses, could be financed using non-budgetary mechanisms (European Investment Bank loans, recourse to Public Private Partnerships, etc.);
- lastly, and above all, because the implementation of the Lisbon Strategy relies first and foremost on legal interventions (e.g. liberalisation measures), and because the overwhelming majority of expenditures concerned[4] are mainly the responsibility of the states owing to the principle of subsidiarity: increasing the "Lisbon" expenditure is therefore intended to be carried out chiefly at a national level, unless it can be

[1] Sapir A. (2003), *An Agenda for a Growing Europe*, Report of the Independent High Level Study Group established on the initiative of the President of the European Commission, July.
[2] This expenditure should represent an average of 8.6% of the Community budget between 2007 and 2013, i.e. less than 0.1% of the EU's GDP.
[3] On this point, see Bertoncini Y. (2006), "The Community budget and the Lisbon Strategy: a crisis in terms of growth or meaning?", Centre d'analyse stratégique, *Strategic Newswatch No. 29*, October.
[4] In 2004, public R&D expenditure financed by the states represented, for example, 0.9% of the EU's GDP, as against 0.05% for that financed by the Community budget; as far as education is concerned, the levels of public expenditure were, respectively, 5.2% of GDP for the states and 0.007% for the EU.

demonstrated on a case-by-case basis that Community financial intervention is more effective (economies of scale, positive externalities, etc.).

Using the Community budget for the purpose of economic stabilisation: a prospect that remains hypothetical

The "MacDougall Report"[5] was published 30 years ago on the request of the European Commission. With a view to ensuring economic stabilisation, it proposed a Community budget of around 10% of Europe's GDP. But present trends in European economic governance, notably in the euro zone, would suggest that the EU budget will not play such a stabilisation role in the medium term.

In the EU, economic stabilisation remains based on monitoring the expenditure of member states.

The creation of the Economic and Monetary Union was accompanied by the introduction of a mechanism to monitor national public expenditure, formalised by the "Stability and Growth Pact": besides the deficit limits it imposes on member states, the pact is based on constituting financial reserves in each member state at the top of each economic cycle in order to guarantee room for manoeuvre in times of economic slump. Though the reform of this pact in 2005 led (in particular) to an improved consideration of structural or investment expenditure to evaluate public deficits, it did not result in a reconsideration of the overall strategy, that is to say the monitoring of national practices rather than Community intervention. Moreover, this strategy has not worked so badly up to now because 8 of the 13 countries in the euro zone (14 countries in the EU-27) have respected the limits defined between 2002 and 2006, and many of them have even shown budget surpluses in the course of this period. A change of footing therefore seems unlikely.

A complementary role for an integrated stabilisation mechanism?

In addition to the Stability and Growth Pact, some observers[6] nevertheless continue to propose setting up a mechanism which would get member states in favourable economic situations to subscribe to a "common fund" aimed at supporting other states in unfavourable economic situations. According to these observers, the total amount of transfers paid or received could be fixed in accordance with the differential in unemployment rate or per capita income compared to the Community average. Such a mechanism does not command general assent today for both political and technical reasons[7]. Supposing it was set up, the budgetary cost entailed would be relatively low for the EU since the contributions of some states would finance the subsidies of others: it is estimated at around 0.1% to 0.4% of the EU's GDP.

Absence of Communitarian consensus on a possible increase in the importance of external expenditure

The prospect of an increase in the importance of "external" European expenditure (mainly external aid and foreign policy for security and defence) - which today represents less than 0.1% of EU GDP - seems, in principle, more open: on the one hand, for reasons of effectiveness and economies of scale and, on the other, because of the strong support expressed by EU public opinion in favour of more coordinated action by member states at an international level. But this increase in importance would only concern the few areas for which a relative political consensus within the Community could be established, i.e. mainly external aid and crisis management, without causing a major quantitative leap for the European Union budget (see table 2).

The increase in Community external aid expenditure should not be substantial:

- even the increased Europeanisation of humanitarian aid expenditure – which is already very advanced – will only cause an increase of a few hundred million euros in the EU budget;
- the EU states have indeed committed themselves to greatly increasing development aid, particularly to reach the "millennium objectives" between now and 2015, but it is first at a national level that they will need to intensify their efforts to reach the objective of 0.7% of GDP, since the multilateralisation of this effort has not been ensured;
- the possible inclusion of the "European Development Fund" within the Community budget will certainly increase the latter by approximately 2 billion euros per year, i.e. a rise that is equivalent to 0.02% of the EU-27's GDP: nonetheless, this inclusion presupposes that the states who do not contribute today will agree to do so in the future, which is not guaranteed.

A sharp increase in Community expenditure for ESDP seems unlikely:

- the European consensus for ESDP is, for the time being, limited to the missions defined at Petersberg, i.e. essentially for "crisis management": on this account, we can certainly anticipate a significant increase in Community expenditure dedicated to "civil" operations (international police, controlling disarmament and

[5] MacDougall D. (1977), Report of the Study Group on the Role of Public Finance in European Integration.
[6] See, for example, Pisani-Ferry J., Italianer A. and Lescure R. (1993), "Stabilization Properties of Budgetary Systems", European Economy: The Economics of Community Public Finance, Reports and Studies; Bajo-Rubio O. and Diaz-Roldan C. (2003), "Insurance Mechanisms against Asymmetric Shocks in a Monetary Union: a Proposal with an Application to EMU", *Recherches économiques de Louvain*, vol. 69, No. 1.
[7] It could nevertheless only function if member states are not subject to the same economic cycles (whereas European countries seem to be synchronised) and without the effect of these cycles persisting.

proliferation); we can also anticipate an increase in Community expenditure financing EU "military" operations (Africa, Bosnia, etc.)[8]; this double increase, which has already been substantial over the last few years, will nevertheless not exceed a few hundred million euros;

- for everything relating to the financing of military operations in the broad sense of the term, the absence of Community consensus would seem to be leading the member states concerned to pursue the implementation of "limited", "reinforced" or "structured" cooperations which would certainly be financed jointly, but difficult to attribute to the EU budget;
- as far as defence is concerned, the states' desire for control has led to coordination efforts on the supply side (rationalisation of defence industries, setting up joint equipment programmes) but not for demand; defence expenditure – which is, furthermore, mainly operational – seems to be destined to remain national in the short and medium term.

Table 2
Distribution of main expenditure in European external aid and ESDP[9] in 2005

(Million euros – 2005)		EU	Member States	Other Budgets	EU (percentage of total)
External aid	Humanitarian aid	794	973 (1)	------	**44.9%**
	Development aid	3 332,9 (2)	42 491 (3)	2 798 (4)	**12.6%**
ESDP	Civil crisis management	47,99		-----	
	Military crisis management	-----		60,8 (5)	
	Other defence expenditure	-----	173 022	-----	**0.063%**

(1) 2004 data. (2) Community expenditure to promote development of relations with the ACP states, Latin America, Asia, the Middle East and the Southern Mediterranean, the Republics of Central Asia, the Caucasus and Eastern Europe, as well as the expenditure related to the instrument for stability and macroeconomic assistance. (3) 2006 data. (4) European Development Fund expenditure, which is not part of the Community budget. (5) This total amount corresponds to expenditure financed by the "Athena" mechanism, managed by the Council but which is not part of the Council's budget (2005 data).
Source: European Commission – Calculations by the Centre d'analyse stratégique – All data refers to 2005 payments, unless otherwise stated

Subordinated to many economical, financial and, above all, political factors, the prospects of increasing the EU budget seem – therefore – low in the medium term. They appear all the more unlikely since they must also rely on a redefinition of the EU budget's financing mechanisms, which also requires consensus between the 27 member states.

Lastly, it goes without saying that a possible Community budget increase is closely linked to developments in discussions of the "Treaty Establishing a Constitution for Europe". The outcome of these discussions will also determine in which skill sectors, and for which objectives, Europeans are resolved to commit themselves through new joint efforts.

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[8] The "Athena" financing mechanism enables the Council's budget to assume – on a case-by-case basis - joint costs (transport, storage, barrack buildings and, indeed, staff) entailed by EU operations.
[9] These intervention expenditures do not include: other CFSP expenditures that do not come under the ESDP domain and which amounted to 16.5 million euros in 2005; expenditure devoted to "enlargement" (which came to 3 438 million euros in 2005); other national and Community external expenditure (namely multilateral relations and general external relations, the European initiative for the democratisation of human rights, relations with OECD countries that are not EU members and the political strategy and coordination of the "external relations" political sphere, etc.).