Fiscal Equalization and Economic Development Policy in the EU

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Is the EU a federation, a confederation, or what?

- The EU has some characteristics of a federation
  - It has decentralized autonomous entities
  - It coordinates national policies toward a common goal
  - Coordination is effected within an institutional setting
- However the EU is *not* considered a federation mainly because
  - There is strong skepticism against centralization (subsidiarity principle)
  - Competencies are partially transferred, institutionally divided, and controlled by national parliaments
  - The process of integration is asymmetrical („opt out“)

Is the EU a federation, a confederation, or what?

- The EU must be considered to be more than a loose confederation, because
  - There are common or harmonized policies, and common institutions: an EU legislative process, an EU Executive, and an EU Judiciary
  - The EU Parliament has only limited power
  - The EU Council is the decisive political body where the member states inject their voice
  - The EU Commission is an „Executive“ whose democratic legitimacy has often been questioned, but it has been the effective driving force of integration

The EU Commission

The EU: Changing directions

- The original objectives were purely political, with “common policies” as the key instrument
- Soon, economic objectives came to the forefront, with market liberalization as the key instrument
- Reciprocity with home-based quality control and consumer protection were the driving forces of creating a “single market”
- The creation of a “level playing field” required tax harmonization and other instruments
- Competition policies are now the single most important policy domain of the EU Commission

The signing of the Treaty of Rome (March 1957)

The EU: Regional enlargement

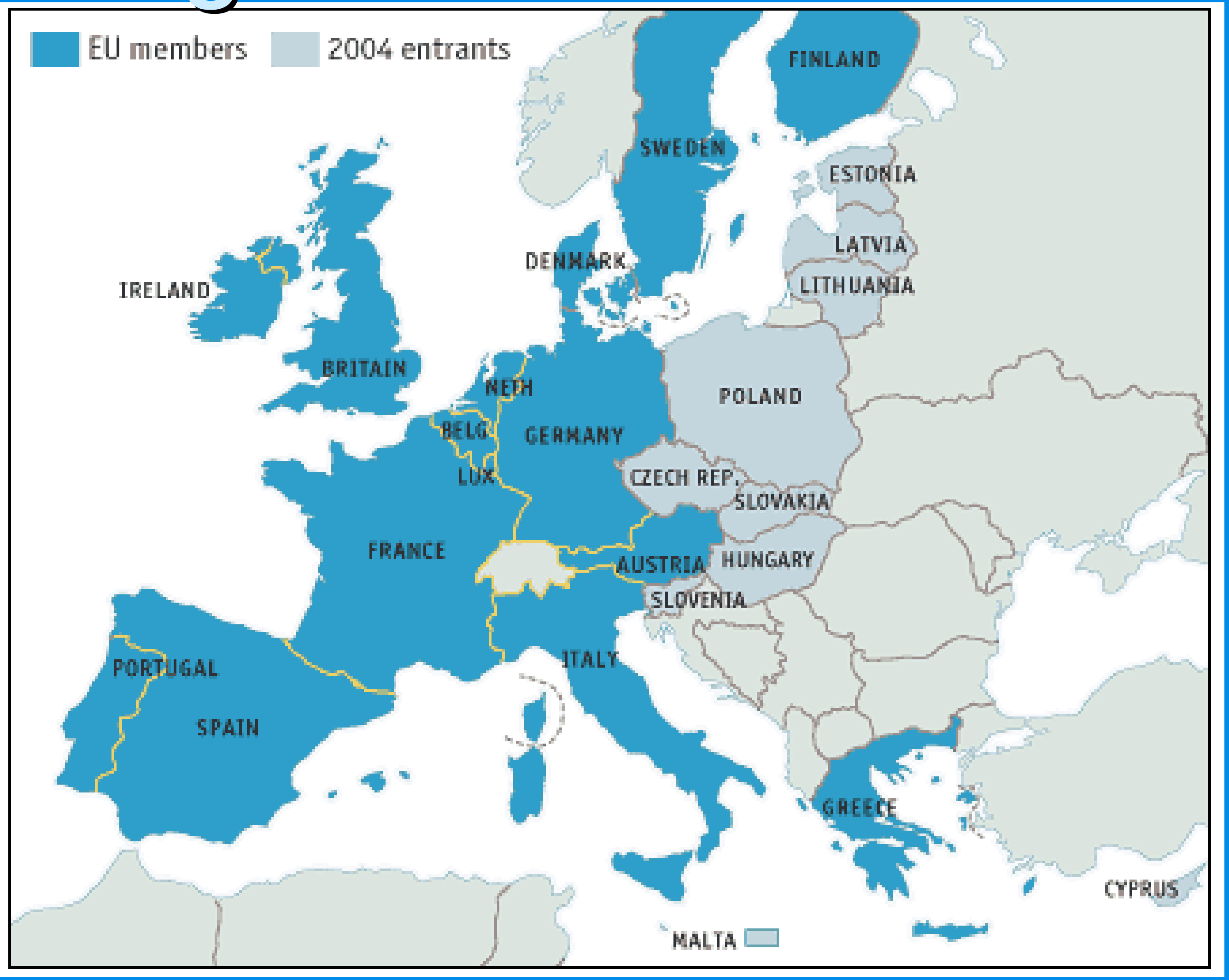
From six at the outset,
the Community now has 15 members:

- the Paris (1951) and Rome (1957) Treaties were signed by France, Germany, Italy and the Benelux countries
- the United Kingdom, Ireland and Denmark acceded on 1 January 1973
- Greece became the 10th Member State on 1 January 1981
- Spain and Portugal acceded on 1 January 1986
- Austria, Finland and Sweden acceded on 1 January 1995

Pending EU Enlargement

- The Commission has recently recommended to admit 10 further countries by 2004
  - Lithuania, Latvia, Estonia, Poland, Czech Republic, Slovakia, Hungary, Slovenia, Cyprus, and Malta
- Two more countries may follow by 2007
  - Romania and Bulgaria
- Turkey has applied, but admission to the EU remains controversial. A decision may be taken after the November elections
- Main Outsiders: Norway, Switzerland, Albania, and the former Yugoslavia (except Slovenia)

The EU and the 1st round of enlargement



The EU's own revenue

- **Agricultural duties, and sugar and isoglucose levies:**
- **Customs duties**
- **VAT resources**
  - These derive from the application of a uniform rate to each Member State's VAT base, determined in a uniform manner in accordance with Community rules.
  - Since the June 1988 reform, the uniform rate was found by applying a 1.4 % rate to the VAT base
- **"Fourth resource"** (created in 1988)
  - This resource is a percentage of GNP
  - It is a variable, budget-balancing resource

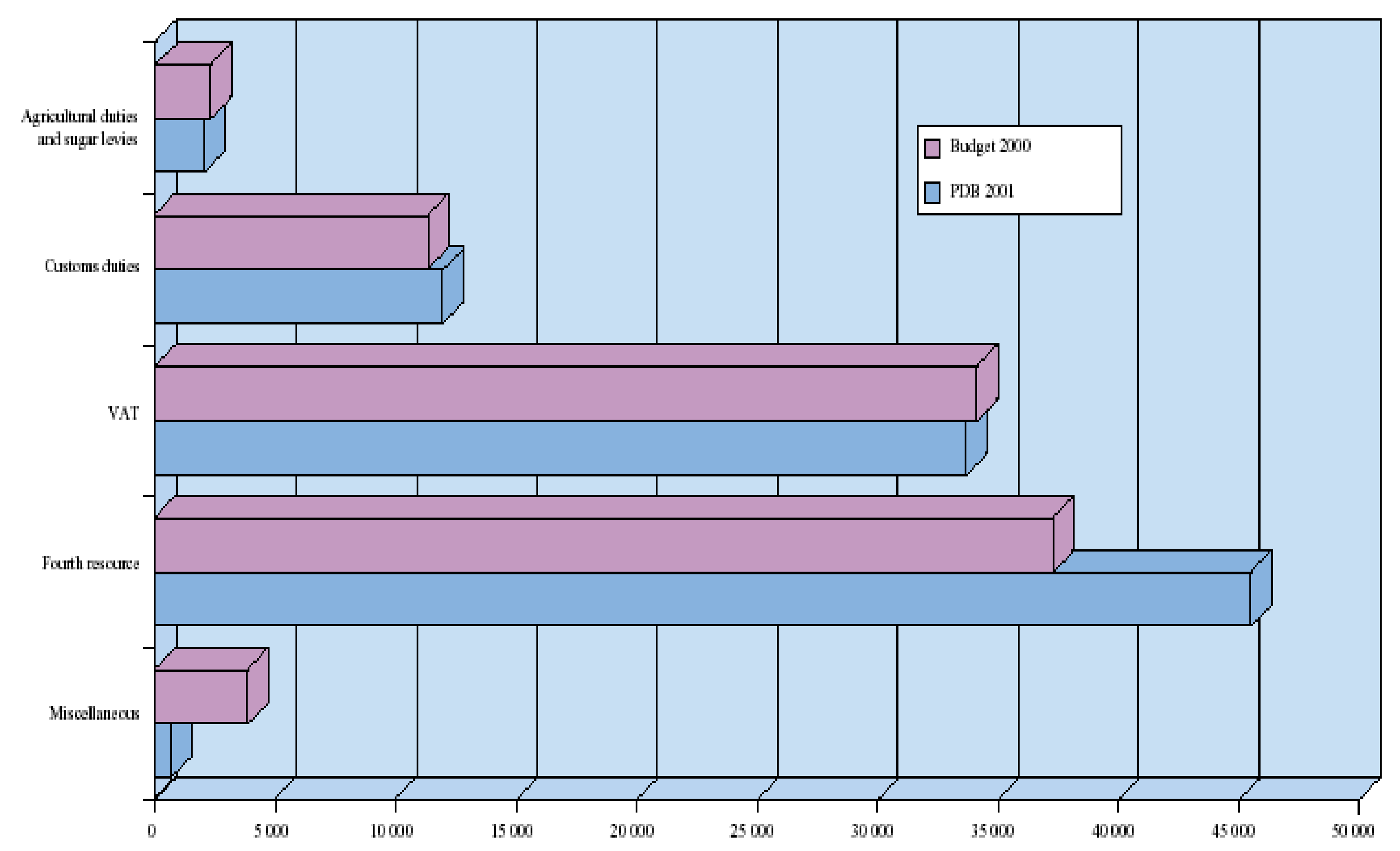
A finance reform

- As agreed at the Edinburgh European Council, a new Decision on the system of own resources was adopted on 31 October 1994.
- This Decision
  - raised the own resources ceiling to 1,21 % of GNP in 1995 and, in stages, up to 1,27 % of GNP in 1999.
  - reduced the uniform VAT rate gradually from 1,4 % to 1 % in 1999 and restricted the VAT base to be taken into account to 50 % of GNP
- The new own resources Decision entered into force with effect from 1 January 1995 after it had been ratified by all the Member States in 1996.

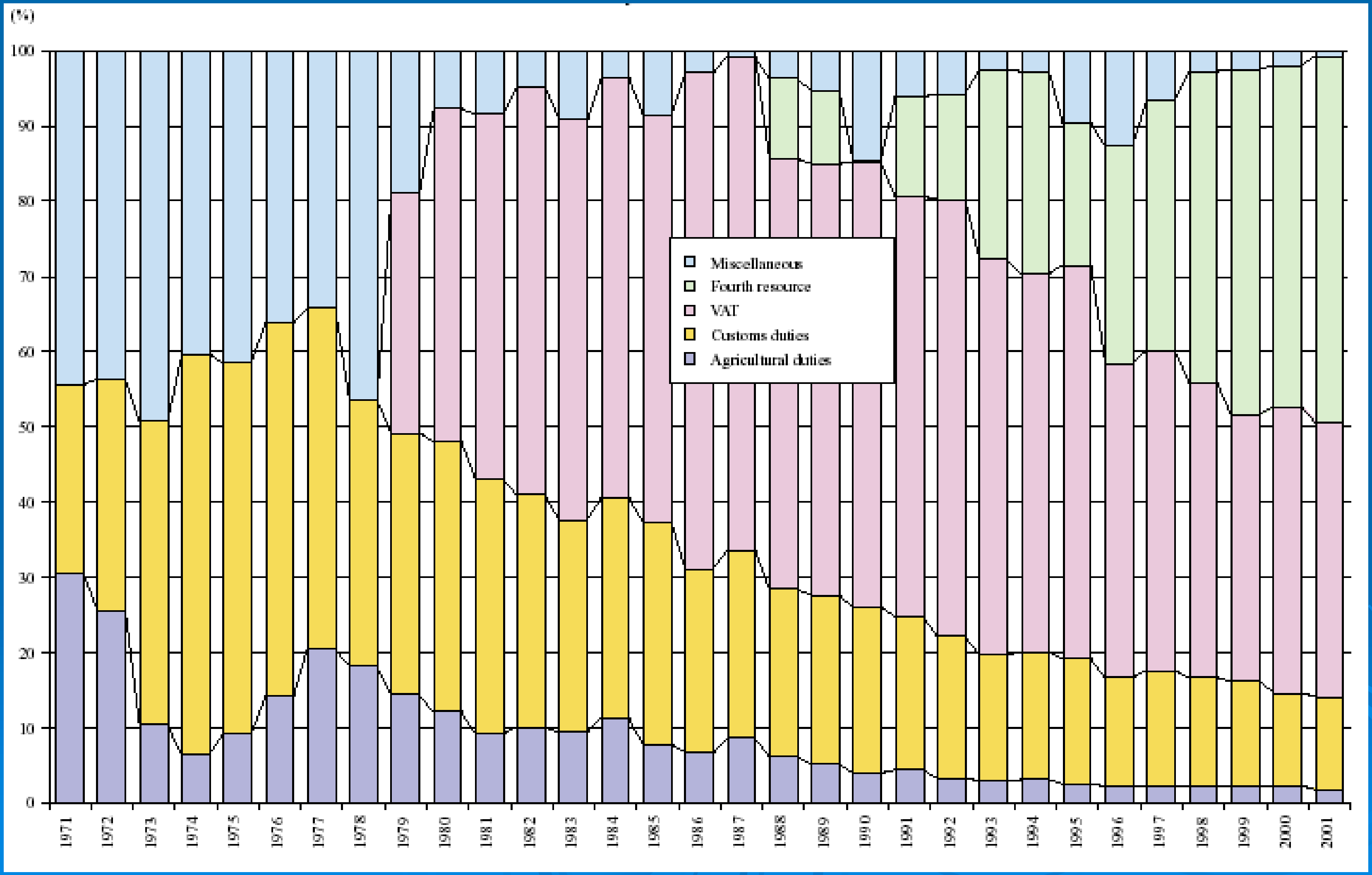
The relative importance of EU revenue instruments (2001)

	Mill. €	Percent of total
Agricultural levies	1,914	2.0
Customs duties	12,292	13.1
VAT	34,049	35.6
Fourth resource	45,516	48.5
Miscellaneous	752	0.8
	93,940	100.0

The importance of EU revenue instruments



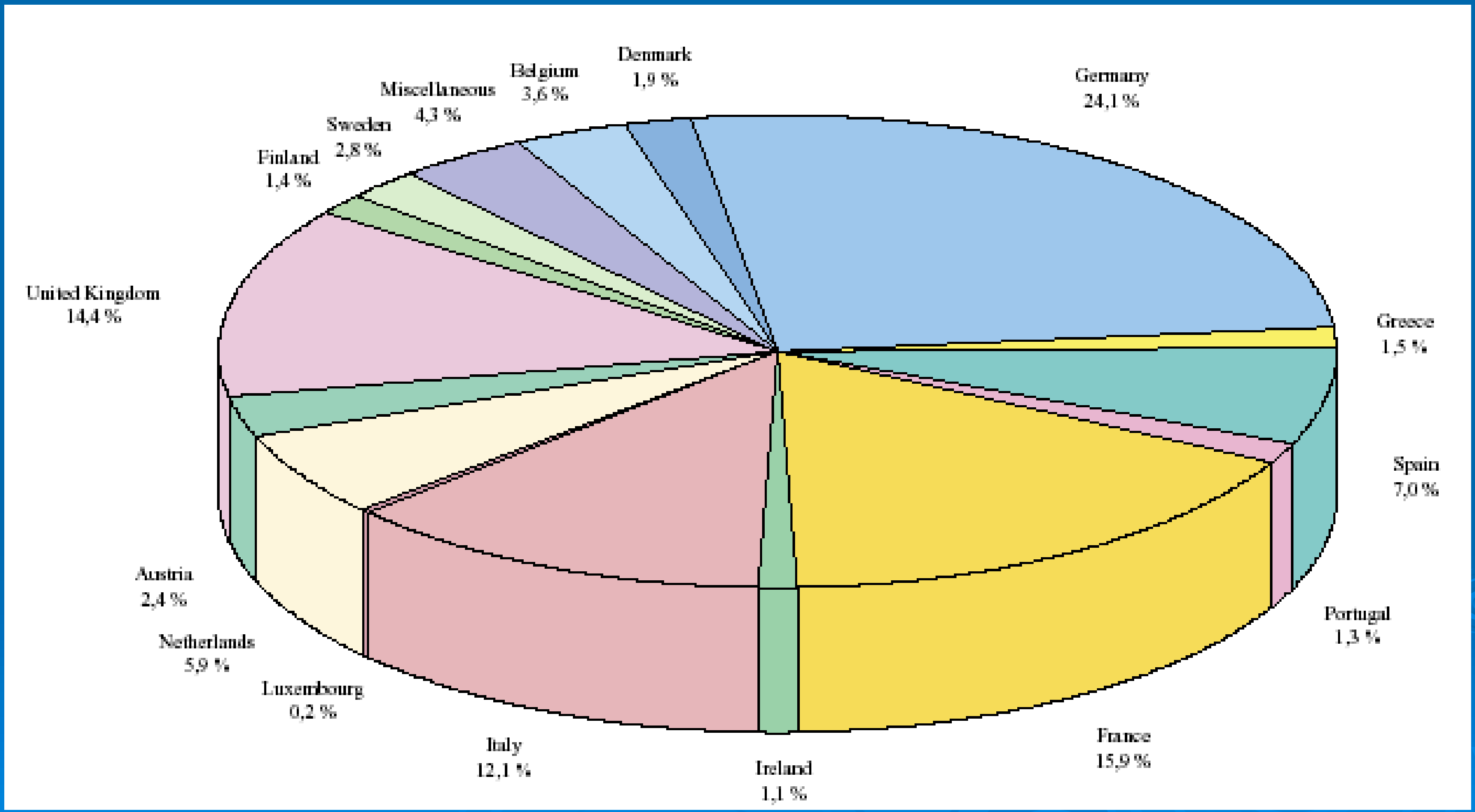
The structural development of revenue instruments



Distributional implications

- There are distributive implications of the EU's revenue system
  - Customs duties and agricultural levies are neutral
  - The VAT share is neutral as to tax rate variations, but tends to work against consumer members (net importers)
  - The "fourth resource" follows GNP and therefore works against the producer members (net exporters)
- The effects cannot be generalized because of
  - special arrangements (United Kingdom, Germany)
  - revenue caps

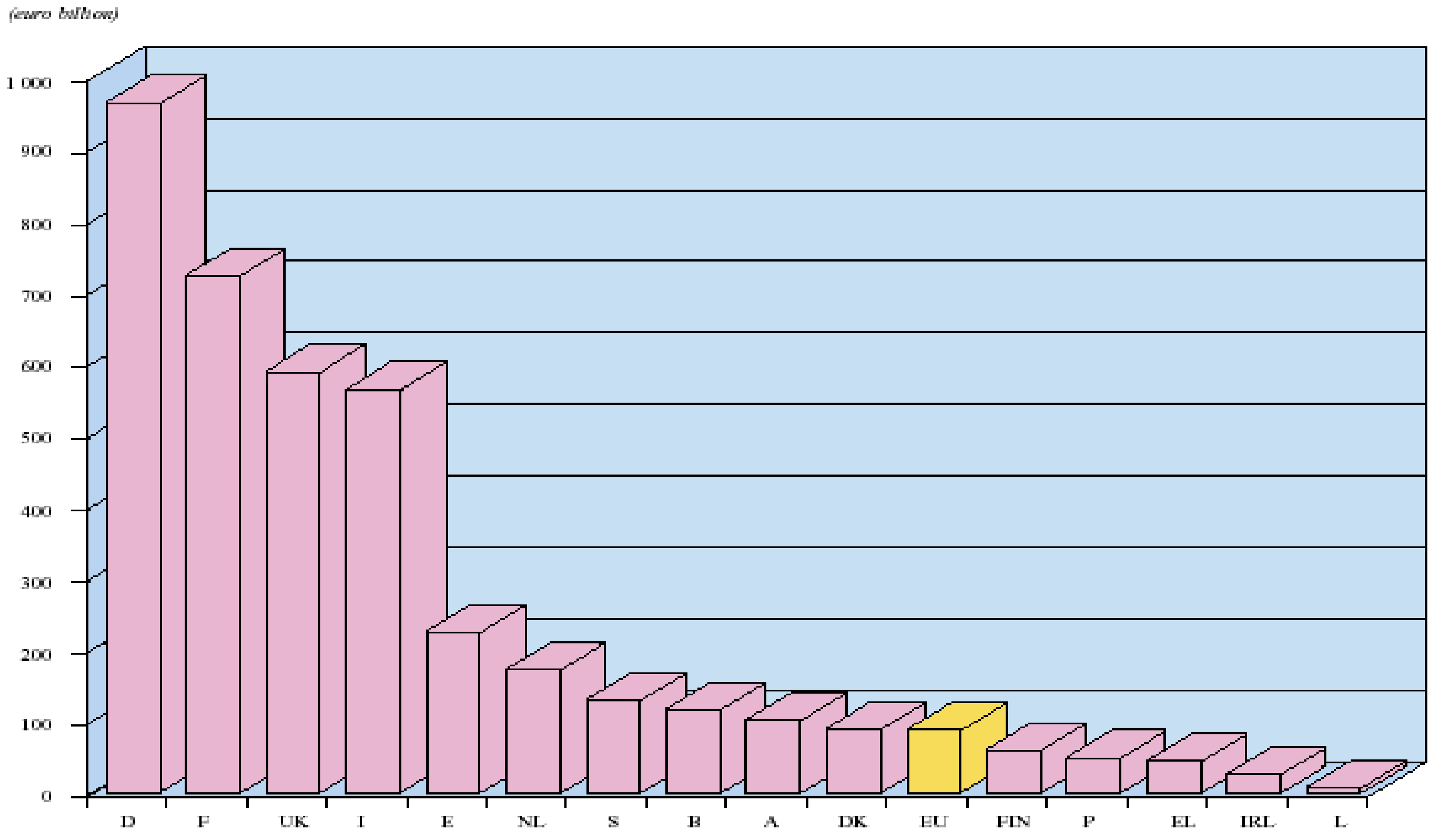
Contributions to the budget by Member State



Revenue equalization

- There is no explicit equalization mechanism on the revenue side
- On the contrary: Concessions were made in favor of richer Member States (UK, Germany)
- More recently, there were also concessions made to the “poorer” members (those qualifying for aid through the Cohesion Fund)
- The main redistributive effects stem from the expenditure side of the EU budget

The size of EU Expenditures



Source: European Commission, DG ECFIN and DG BUDG.

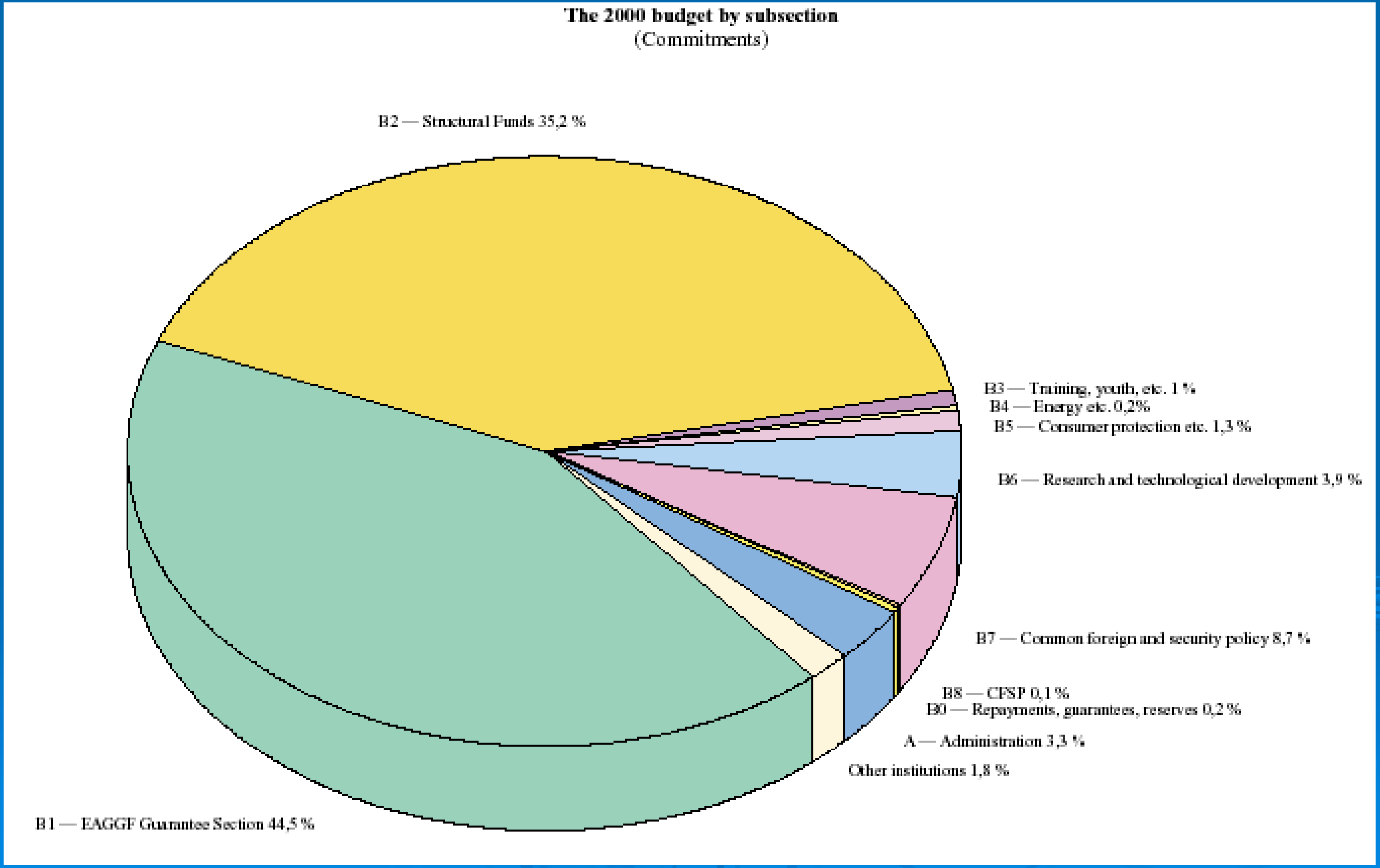
Compulsory vs. non-compulsory outlays

- The distinction between compulsory expenditure and non-compulsory expenditure is basically political in that it determines the division of power over the budget between Parliament and the Council
- Compulsory expenditure is defined to be expenditure „which the budgetary authority is obliged to enter in the budget to enable the Community to meet its obligations, both internally and externally"
- All other expenditure is non-compulsory
- The problem of classifying outlays is a source of conflict between the two arms of the budgetary authority

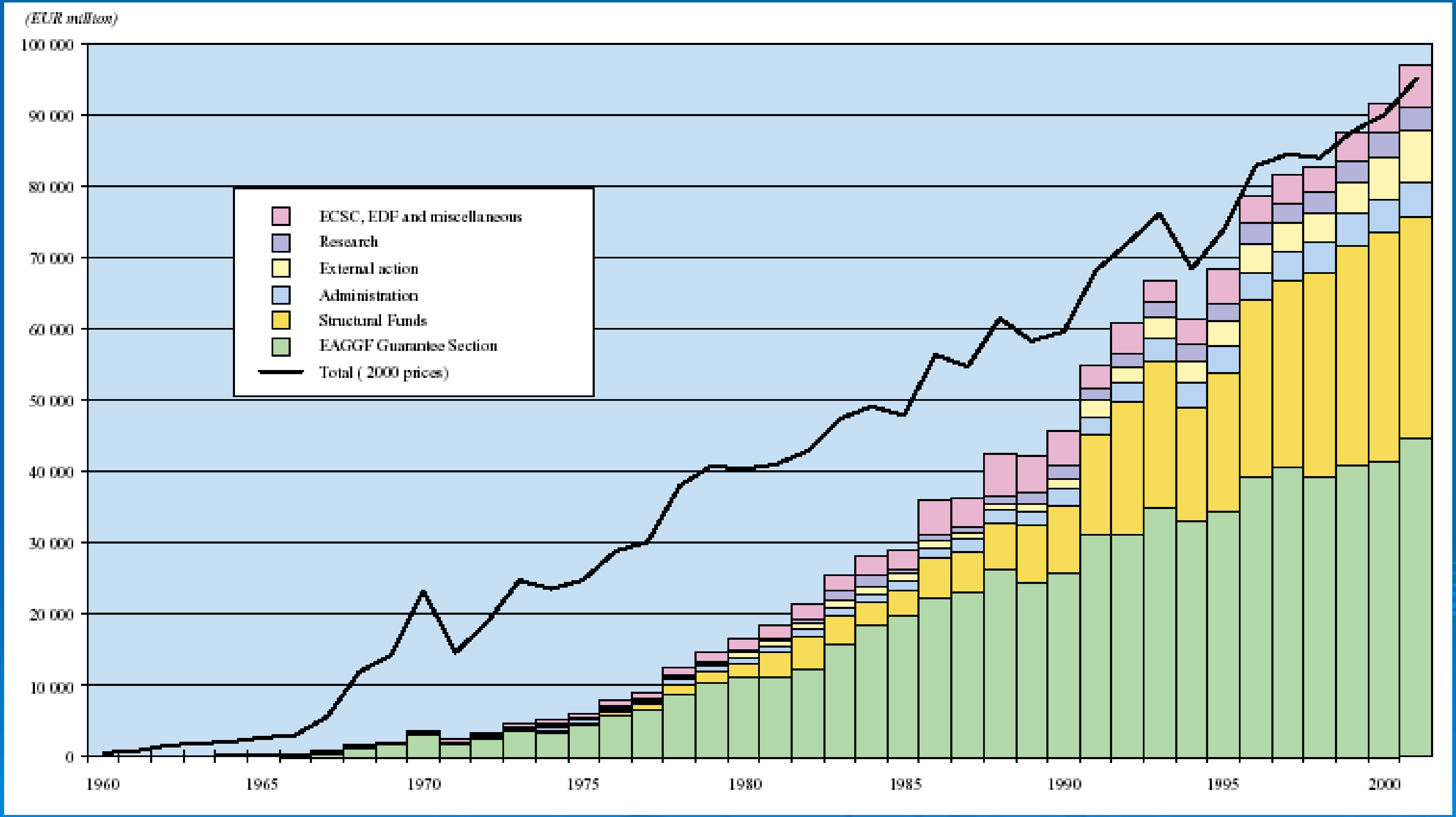
The structure of Community outlays

- General Budget
  - **European Agricultural Fund** (EAGGF Guarantee Section)
  - **Structural Funds**, *of which*
    - European Agricultural Fund (EAGGF Guidance Section)
    - European Regional Development Fund (ERDF)
    - European Social Fund (ESF)
    - Cohesion Fund
  - **Research**
  - **External action**
  - **Administration**
- European Development Fund (EDF)
- European Coal and Steel Community (ECSC)

The structure of EU outlays



The development of Community expenditures



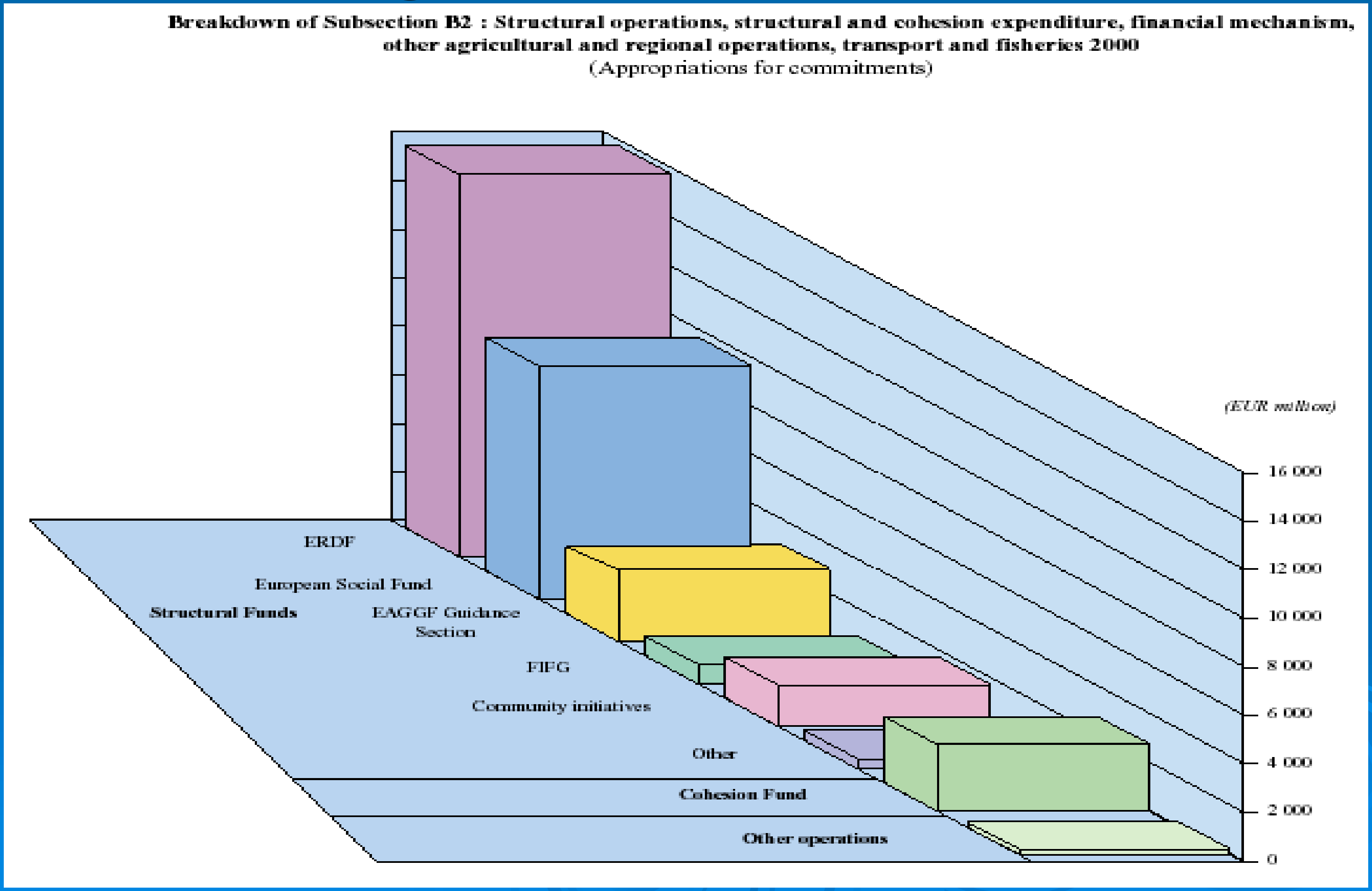
The Common Agricultural Policy (CAP)

- The CAP has the following objectives:
  - to increase agricultural productivity;
  - to ensure a fair standard of living for the agricultural community;
  - to stabilize markets;
  - to guarantee the availability of supplies;
  - to ensure that supplies reach consumers at reasonable prices.
- To achieve these objectives, the common agricultural market was based on three principles: a single market, Community preference, and financial solidarity
- A common Fund (EAF) was created in 1962.
- In 1964, this Fund was divided into two sections — the Guarantee Section for outlays arising from price policy, and the Guidance Section for Community expenditure resulting from structural policies in agriculture

Structural Funds

- Subsection B2 of the budget covers structural operations, including
  - operations under the Structural Funds (European Regional Development Fund (ERDF), European Social Fund (ESF) and the EAGGF Guidance Section),
  - the Financial Instrument for Fisheries Guidance (FIFG)
  - and, since 1993, the Cohesion Fund.
  - It also includes some internal policies: other agricultural and regional operations, transport and fisheries.

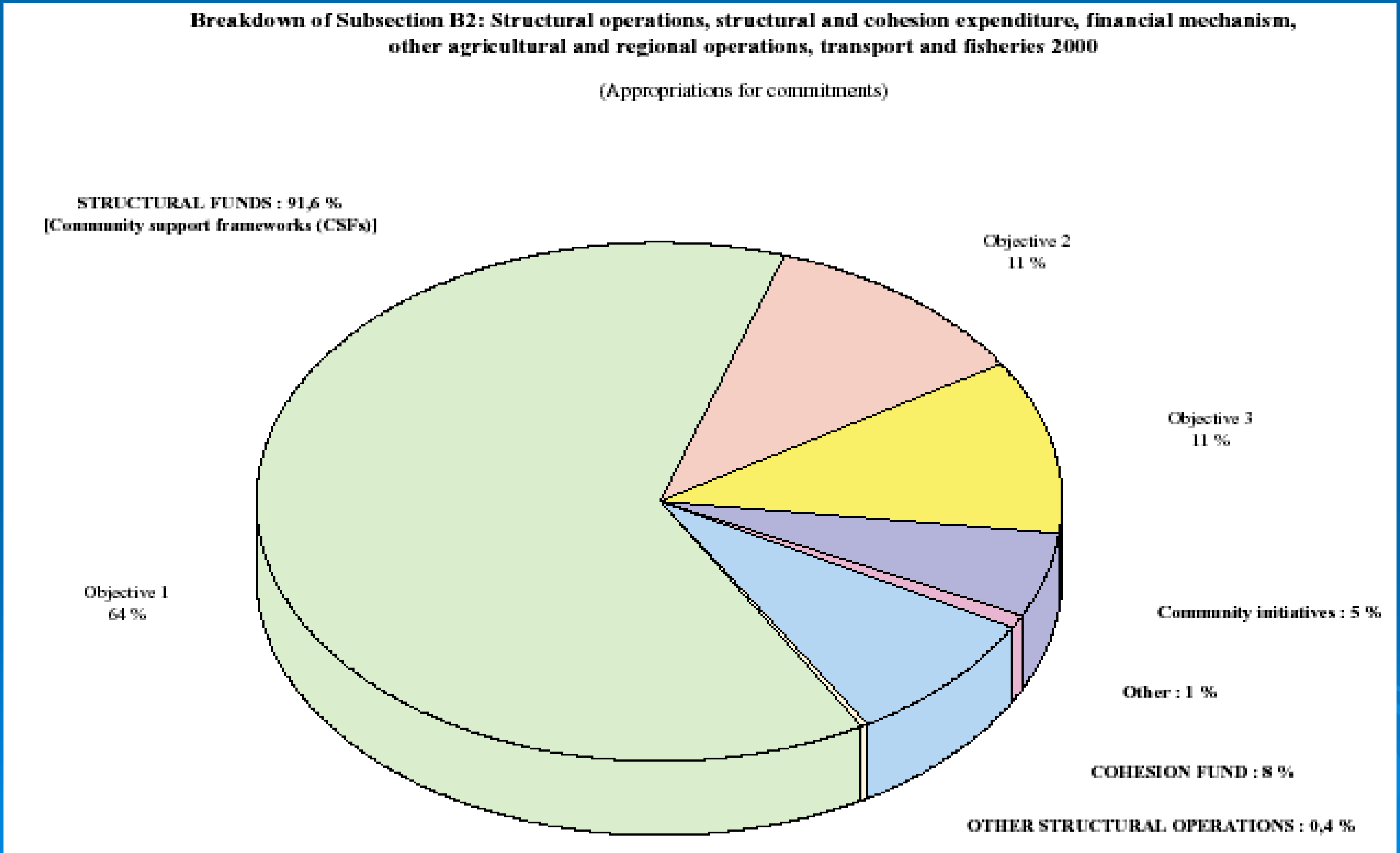
Breakdown of SF according to subfunds



Structural Funds: Objectives

- With the appropriations for the Structural Funds and the FIFG, the Union supports the following seven objectives:
  - 1: promoting the development and structural adjustment of economically lagging regions;
  - 2: converting regions affected by industrial decline;
  - 3: combating long-term unemployment and facilitating job creation for young people and excluded persons;
  - 4: facilitating the adaptation of workers to changes;
  - 5a: speeding up the adjustment of agricultural structures;
  - 5b: facilitating the development of rural areas;
  - 6: development and structural adjustments of regions with an extremely low population density.

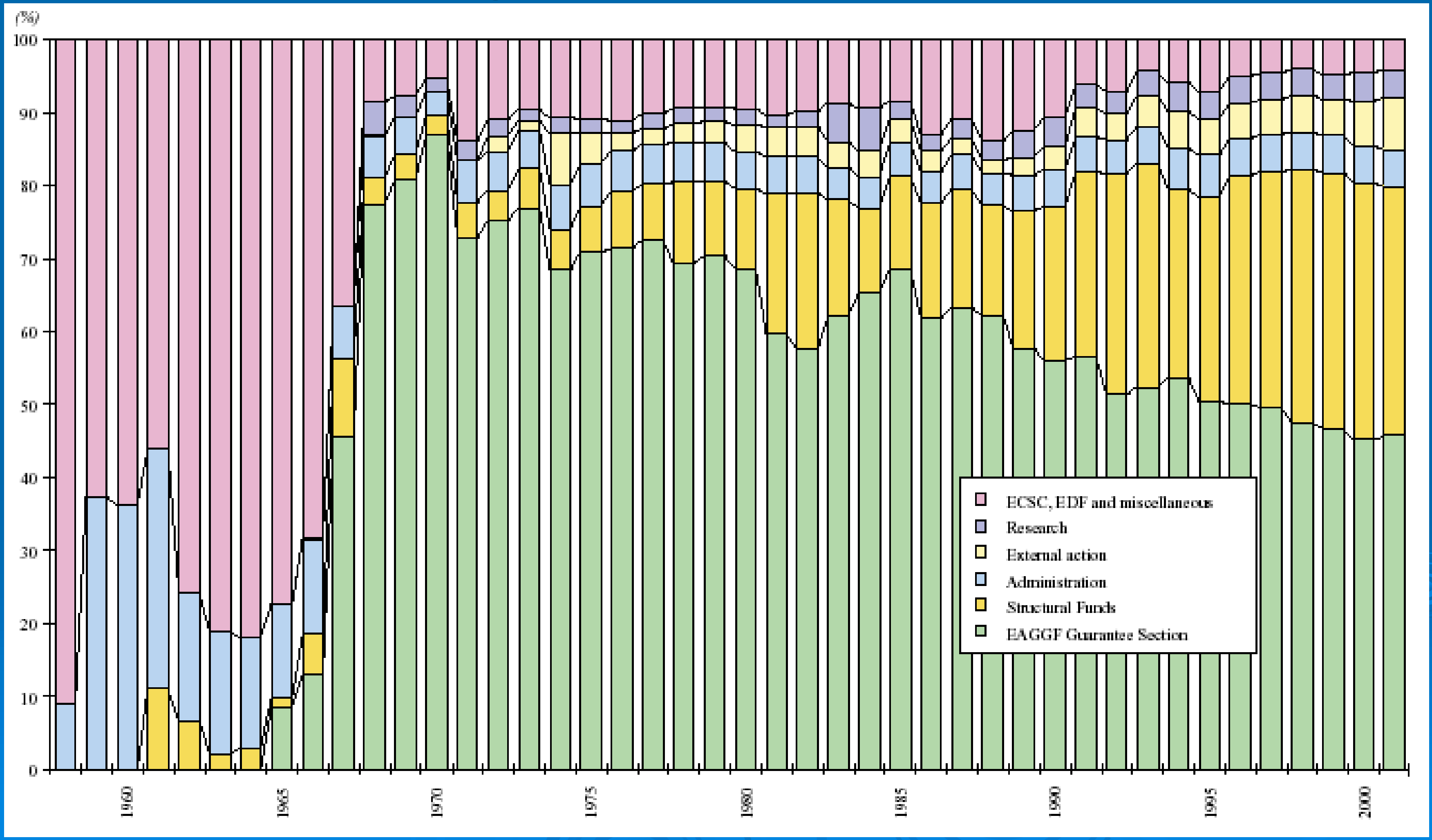
Breakdown of SF according to objectives



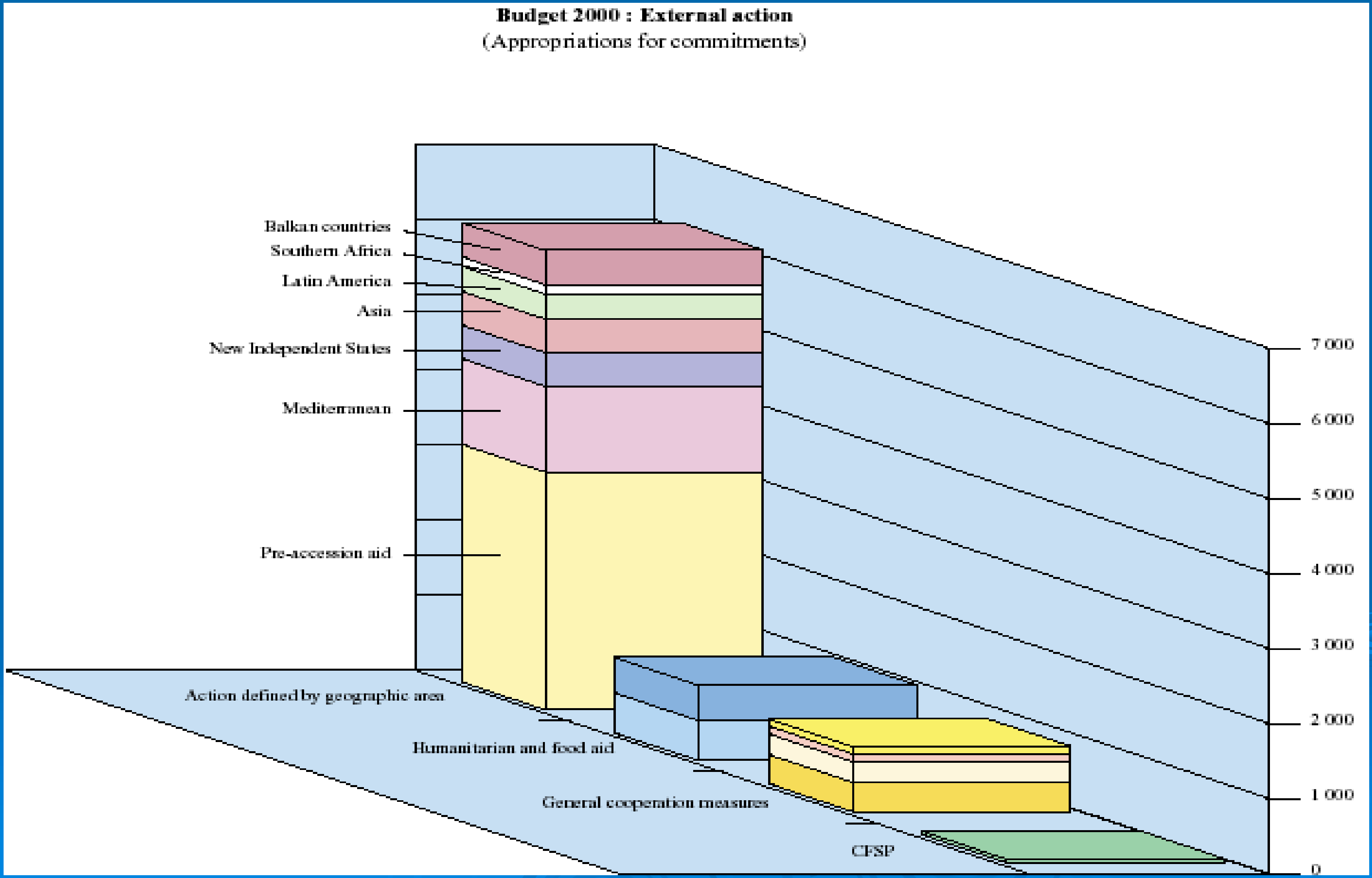
Cohesion Fund

- With the Cohesion Fund appropriations, the Union is making a financial contribution to environmental projects and trans-European transport infrastructure networks in those Member States with a per capita gross national product which is less than 90 % of the Community average, measured on the basis of purchasing power parities (Greece, Spain, Ireland and Portugal).
- The rate of Community aid amounts to between 80 % and 85 % of public or similar expenditure.

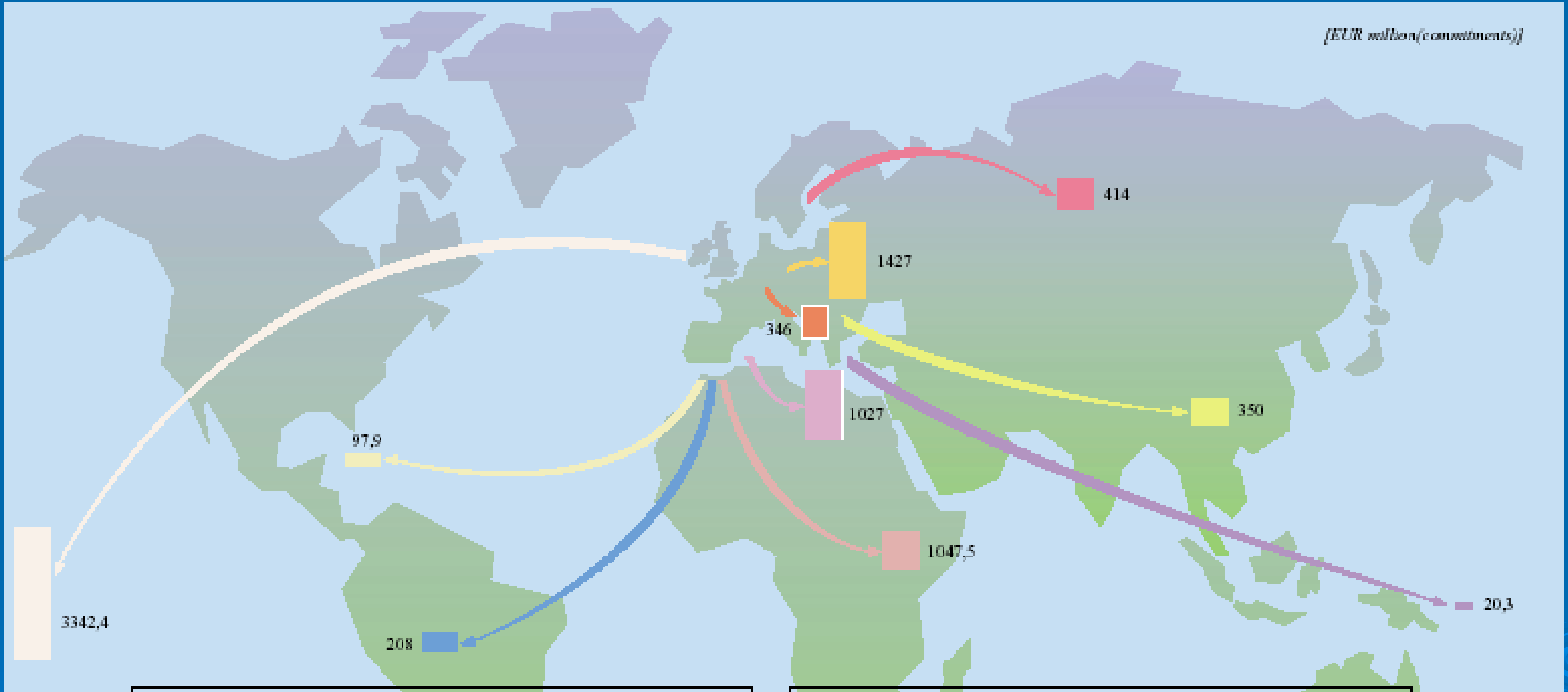
Structural development of EU outlays



External actions (2000)



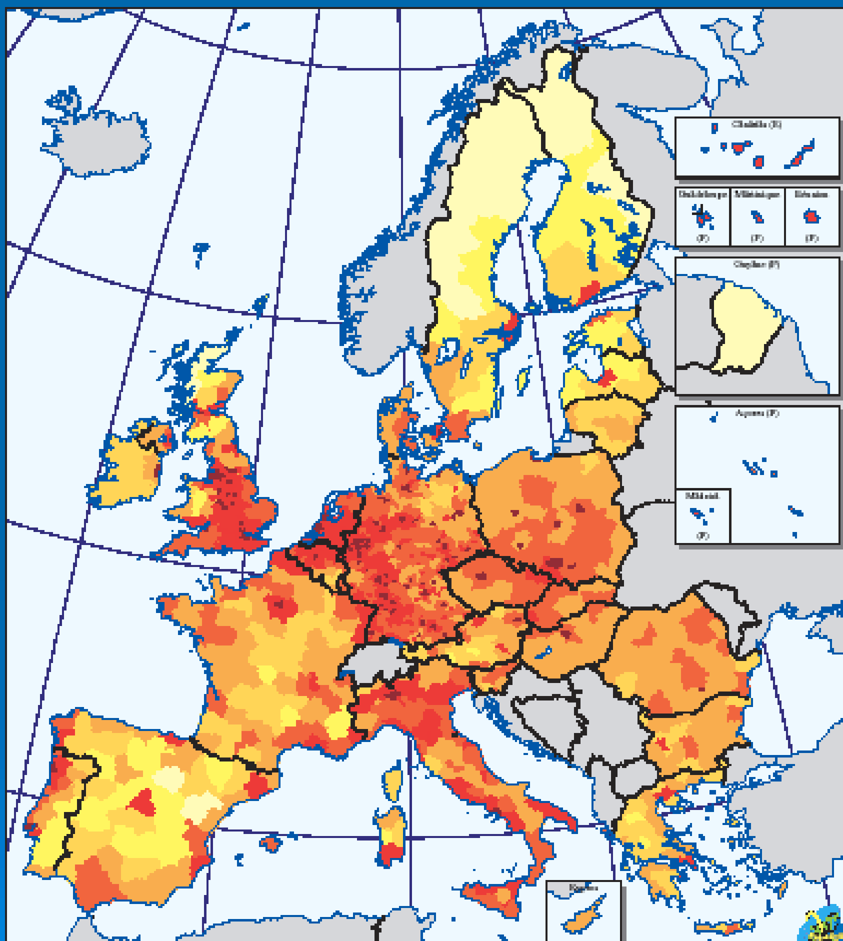
European Development Fund: regional incidence (1999)



Africa	1047,5
Caribbean	97,9
Pacific	20,3
Latin America	208
Asia	350
Mediterranean	1027
Eastern Europe	1427
New independent States	414

Balkan countries	346
Other operations :	3342,4
– CFSP	29
– Humanitarian aid and emergency reserve	726
– Food aid	505
– External aspects of certain Community policies	359
– Democracy and human rights	94
– Other cooperation measures	354
– ACP and OCT regional measures	1275,4

EU regions: Population density

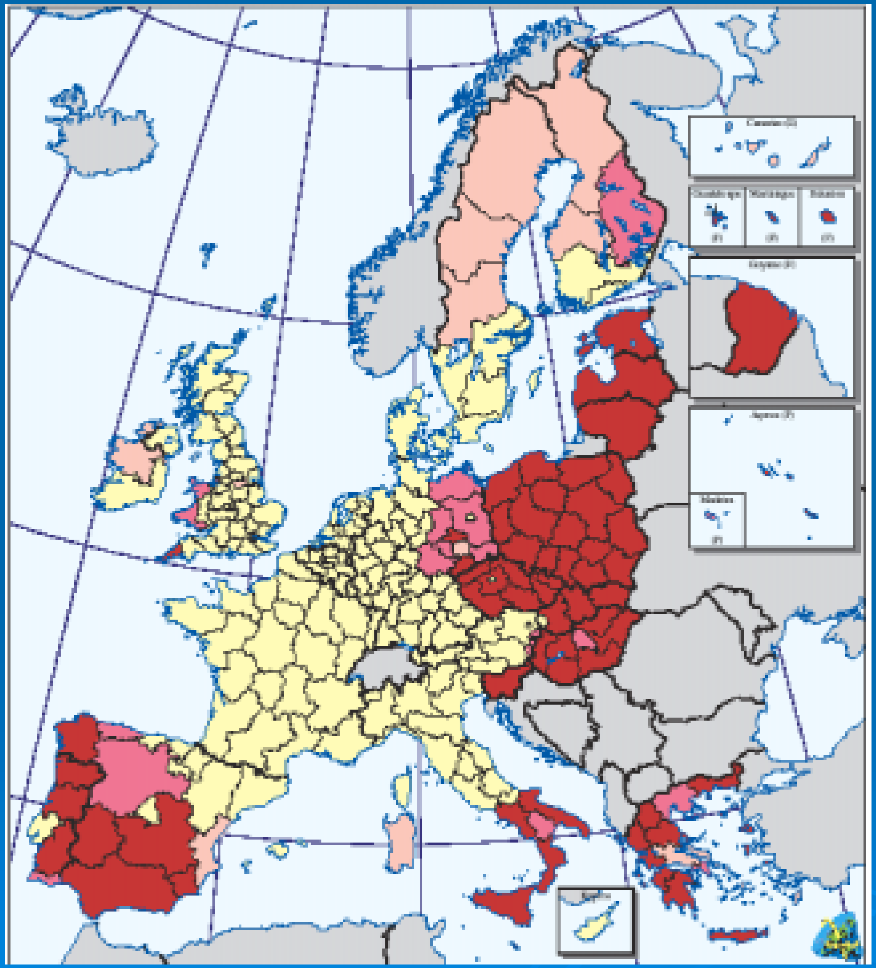


- Population density varies substantially among EU regions

Inhabitants/km^2

- < 10
- 10 - 25
- 25 - 50
- 50 - 100
- 100 - 200
- 200 - 500
- 500 - 1000
- > 1000

EU regions: GNP per capita



- And so does their economic potentials

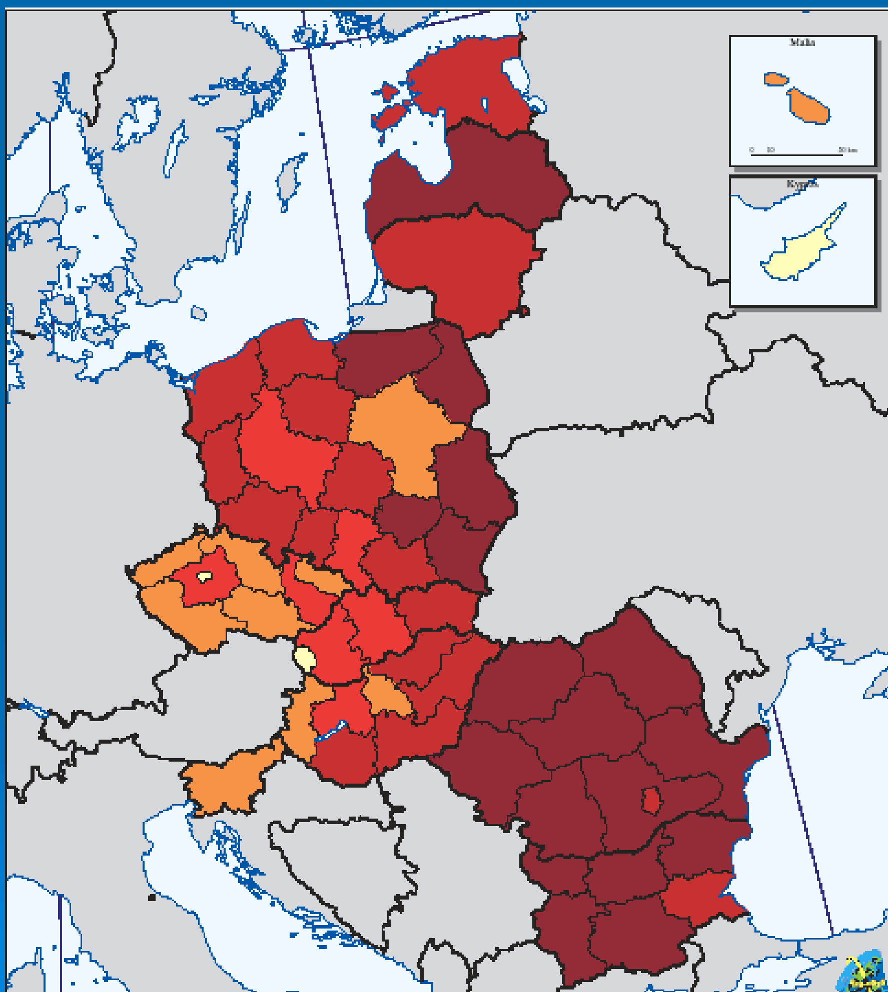
Regions below 75% of EU 25 average

Supported regions above 75% of EU 25 average (expires 2006)

Supported regions above 75% of EU 15 average (expires 2006)

Other regions

EU regions: GNP/capita
The accession countries



- Index EU 15 = 100

< 30
30 - 40
40 - 50
50 - 75
> 75

- THE EU IS DEFINITELY HEADING TOWARDS ITS BIGGEST CHALLENGE
- WILL IT WORK WITHOUT EXPLICIT REGIONAL EQUALIZATION ?

Thank you for your attention.