

## Poland's reply to "A PUBLIC CONSULTATION PAPER IN VIEW OF THE 2008/2009 BUDGET REVIEW"

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A debate about the future of the European budget is inseparably linked to a discussion on the future of the European Union. As a matter of fact this is a debate about the vision of the European integration that we want to carry into effect in the years to come. Therefore the budget review is not the proper forum for a discussion about allocation of funding to individual states, and even more so for a revision of the financial perspective agreed for the years 2007-2013.

The main reason behind changes proposed in the budget review should be constituted by the **aim for deepening of integration and improving the effectiveness in attainment of jointly set goals**, instead of aiming at a change in the distribution of financial flows ensuing from membership (financial flows between the EU budget and member states budgets constitute a very minor part of all membership implications).

Guided by this fundamental message, the government of the Republic of Poland joins the open debate about the future of the European integration model, including the common budget, in belief that there should be no taboos therein.

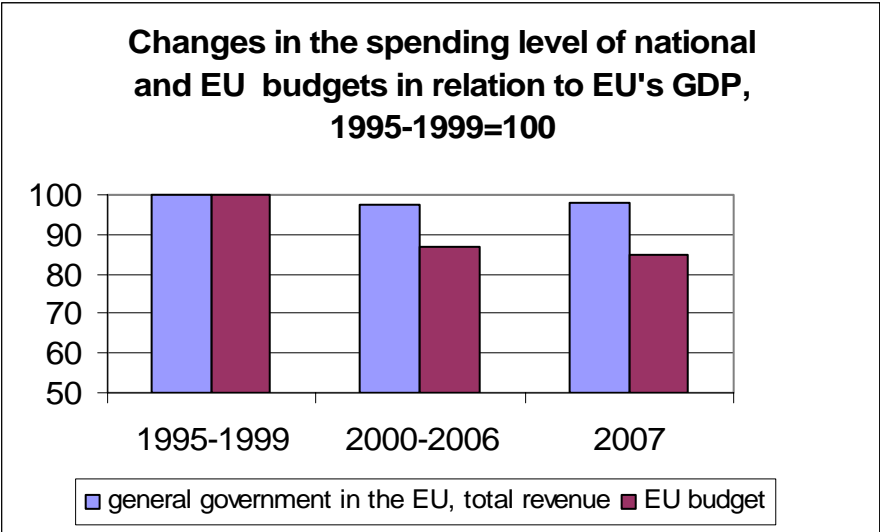
### ***1. Has the EU budget proved sufficiently responsive to changing needs?***

The process of budget evolution is constantly in progress. The **budget structure** (relationships between individual headings) is changing. In 2008 spending from the EU budget under *Sustainable growth* heading (heading 1 of the budget) has already exceeded the level of spending on direct payments and market interventions in agriculture. EU budget increasingly finances measures pertaining to implementation of the Lisbon Strategy for growth and jobs, including measures effected through spending on cohesion policy (cohesion for growth and employment) under heading 1. It must be stressed, however, that regardless of budget structure changes, **the substance of individual policies also evolves** in response to emerging challenges. As a result of several reforms, the Common Agricultural Policy changed from a traditional policy of sustaining prices of agricultural products into a modern policy enabling farmers to make free production-related decisions depending on signals from the marketplace, strengthening competitiveness of the agricultural sector, simultaneously implementing natural environment protection goals and other goals. With the adoption of the *Integrated Guidelines for Growth and Jobs*, cohesion policy has become a key instrument in the attainment of Lisbon Strategy objectives, thus targeting the undertaken actions at strengthening of the competitiveness of the EU, its member states, as well as individual regions. Due to CAP's multi-dimensional character, its instruments also lead to attainment of Lisbon Strategy objectives.

However, **a barrier to more profound budget adjustments is constituted by reduction of its level in relation to GNI of the EU**. If 2007-2013 financial perspective maintained the spending level in relation to GNI of the EU at 1993-1999 value, we would have at our disposal additional EUR 200 billion for implementation of European policies. For the sake of comparison, the aggregate seven-year budget of the Seventh Framework Programme for Research and Technological Development amounts to mere EUR 50 billion (in 2004 prices).

Budgetary discipline should remain one of the design principles of the EU budget. However, the evolution of the European budget must not be contemplated separately from public spending made at national and local level. Evolution of the size of national budgets and EU budget in recent years indicates that the practice of budgetary discipline is different at national and at European level. While in the years 1995-1999 the EU budget constituted approximately 2.3% of public spending in EU states, in the first years of the present financial perspective this value is closer to 2% of the European public spending.

The diminishing role of the European budget ensues from the fact that the **pressure to decrease the EU budget is much stronger than the pressure to reduce spending from national public finance**. Total revenue of general government sector (i. e. burden put on EU citizens) in the years 1995-1999 amounts on the average to 45.8% of the GDP of the EU (such were annual average revenues of the *general government sector*). In the years 2000-2006 and 2007 revenues of *general government sector* were reduced respectively to the level of 44.7% and 44.9% of EU GDP. This means that burden pu on citizens was reduced by approximately 2% (i.e. 0.9-1.1 % of GDP).



At the same time revenues of EU budget in relation to EU GDP<sup>1</sup> were reduced by 15.4% (by 0.2 % of GDP) from the level of 1.12% EU GDP in the years 1995-1999 down to 0.95% of EU GDP in 2007. The budget reduction trend will be continued also in the time perspective of the year 2013. Evolution of European budget spending and national budgets spending has been presented in the attached chart.

Continuation of the European budget reduction trend is bound to reduce its responsiveness to changing needs.

Budgetary discipline must not – as it used to be so far - lead to a deeper reduction of EU budget than of national budgets.

<sup>1</sup> Considered as payments actually executed.

## ***2. How should the right balance be found between the need for stability and the need for flexibility within multi-annual financial frameworks?***

The EU budget should be first of all an **instrument enabling long-term measures for attainment of European development goals**. Significance of the the EU budget as an instrument serving the purpose of making ad-hoc interventions should not be of primary character, also due to limited resources. Viewed from this perspective, stability offered by seven-year financial frameworks should be perceived as a way of improving the effectiveness of public spending.

The multi-annual character of financial frameworks extorts in relation to a majority of policies financed from EU budget that decisions be made on the basis of **developed strategies** and operational plans, specifying objectives and priorities of social and economic development, and the method of their financing.

The long time perspective **enables continuity of actions** specified in multi-annual strategies and programmes, creating stable frameworks for national governments, regions, entrepreneurs, farmers, scientific and research centres, NGOs and other beneficiaries of he EU budget.

Multi-annual programming forced by seven-year character of financial frameworks also enables **coordination and cohesion of actions carried out at the Community level, with measures deployed in the member states and regions**. As a result the strategies developed at the European level (including Lisbon Strategy for growth and jobs), supported with financial incentives, can become a significant point of reference in the programming of actions benefiting structural changes at the level of member states, regions and sectors of economy supported from the EU budget.

Multi-annual programming forces an integrated approach during deployment of development challenges, stimulates public and private capital for more effective investments and deepens integration by supporting completion of a single European market, and also contributes to institutional convergence through dissemination of modern models of multi-annual strategic and financial management (including also dissemination of *know-how* or transfer of good practices).

Simultaneously the possibility of revising strategic documents – including those at both Community and national level – and programmes of the member states, ensures flexibility. Due to all aforementioned factors, multi-annual programming takes due account of the evolution of socio-economic situation, or major changes in Community as well as in national and regional challenges and priorities.

The seven-year span of financial frameworks, which make the EU budget into an instrument enabling long-term strategic actions, implementing European development goals, is a good illustration of balance between the need for stability and flexibility and it should be maintained.

**3. Do the new policy challenges set out for EU policies in the Consultation Paper effectively summarise the key issues facing Europe in the coming decades?**

**How should policy objectives be properly reflected in spending priorities? What changes are needed?**

**Over what time horizon should reorientations be made?**

The Consultation paper from the European Commission correctly identified the range of key issues facing Europe. However, **if new development challenges are to be effectively met, it is prerequisite to strengthen Union's cohesion, both in its social, economic and territorial dimension.** The degree of Community's cohesion will determine the ability of **EU to adapt to structural transformation.**

As of today the disparities in development levels constitute a **barrier to deepening of integration, particularly in economic dimension,** which is evidenced by difficulties in taking full advantage of the potential of knowledge and innovation inherent in the EU-27. Absence of territorial cohesion weakens Europe's mobility and dynamism, and also reduces development potential of certain regions, particularly of rural areas. However, the significance of cohesion **should not be limited merely to bridging of the development gap between less and more developed EU areas.**

The fundamental method of improving the focus of actions of member states and regions on deployment of new development challenges should consist in **further reforms of the existing policies, carried out in a way taking due account of their impact on objectives set forth in Article 158 of the Treaty<sup>2</sup>.** Such approach shall ensure proper balance between the need for evolutionary changes, and the need to adjust to changing external circumstances. The use of *delivery mechanisms* developed under the existing policies shall also contribute to ensuring a greater effectiveness of public spending.

**Counteracting climate change** will also constitute one of the development challenges faced by the EU. Central importance for efficiency of EU response to this challenge will be played by regulatory solutions, including the extent to which they will reflect the treaty objective of aiming at economic convergence. However, development policies financed by the EU budget should also contribute to addressing climate change and adaptation to the effects thereof. There are several measures falling under this trend. Those include actions supporting development of renewable energy, modernisations aimed at energy conservation, transport solutions, water economy (increasing retention, anti-flood measures), and protection against erosion, forestation, protection of biodiversity. A particular role in counteracting climate change, environmental protection and sustainable development will be played by the Common Agricultural Policy. Introduction of the rule of interdependence, improvement of water resources management, care for biological and landscape diversity, growing importance of the production of bio-mass and economy using eco-fuels make environmental and climate issues an indispensable element of any farming activity. Adjustment of the budget to respond

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<sup>2</sup> Article 158 of the Treaty Establishing the European Community: "In order to promote its overall harmonious development, the Community shall develop and pursue its actions leading to the strengthening of its economic and social cohesion. In particular, the Community shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions or islands, including rural areas."

to climate change should also assume the form of thematical concentration of outlays within EU Framework Programmes for research and technological development, i.e. increasing spending on R&D activities leading in the future to countering climate change.

The common budget should support **actions aimed at growth and jobs**, by promoting development and flow of knowledge through educational and research programmes, mobility, competitiveness and innovation. Particular importance in providing incentives to enhance the potential of competitiveness and innovation of the member states and regions should be also assumed in the future by cohesion policy, which has inherent potential for creation and promotion of best solutions in the scope of technological research and development and translating them into economic growth.

One of the fundamental development challenges is **to ensure security to EU citizens**; security understood quite broadly – from public health to energy security, security of borders, combating terrorism and crime. It is necessary to follow-up and strengthen actions under the Common Agricultural Policy benefiting food security and quality, prevention of epidemics, observance of standards in the scope of environment protection, public health and animal welfare. It is also in the interest of the Union to expand the area of security, particularly in the immediate neighbourhood, **promote and protect European values in a changing international environment**. This goal can be attained mainly by expanding the single market and covering third states with Community programmes, as well as by deepening of the European dimension of EU actions and a further increase of the European added value. It must be borne in mind, however, that expansion of the single market is tantamount to dissemination of European standards. For this reason the Union must have at its disposal reinforced financial instruments supporting the common market expansion process.

Deployment of a majority of challenges indicated in the *Consultation paper* will entail significant burdens, including financial outlays. However, the share of spending from the EU budget, also due to the size of the common budget, will remain limited. The main burden ensuing from deployment of jointly set goals will be borne by budgets of the member states and regions as well as entrepreneurs and consumers. Therefore the common budget, supporting deployment of development challenges, including in particular measures benefiting full convergence, should play the role of a mechanism **servicing the purpose of attaining convergence at the level of EU goals, policies and their practical implementation consistently across all member states**.

Budget reorientation, not only on the spending side, but also of the revenue side of the EU budget, should take place gradually (**gradualism of changes**) and be implemented during the next financial perspective. The extent of changes is linked to EU budget evolution (when budget is decreased, the leeway for changes thereof will be narrowed).

Social, economic and territorial cohesion will determine EU capacity to adapt to the times of structural change.

The fundamental method of improving the focus of actions of member states and regions on deployment of new development challenges should consist in further reforms of the existing policies, carried out in a way taking due account of the objective set forth in Article 158 of the Treaty already at the stage of legislative initiatives.

Budget reorientation should be gradual during the next financial perspective.

#### ***4. What criteria should be used to ensure that the principle of European value added is applied effectively?***

The EU budget is and should be an effective instrument supporting implementation of European policies, particularly at the national and regional level.

The EU budget should create **incentives for deployment of jointly determined goals**. The common budget should constitute a catalyst for deployment of ambitious endeavours (such as for example creation of a single market starting from early 1980's). The EU budget is an instrument enabling **directing of public spending**, also at the national and regional level, **to objectives set forth at the European level**.

As a result of the differences in economic potential, the states and regions of the EU differ in their capacity to generate public resources, which may serve the purpose of attaining EU objectives. Decisions made at the Community level may also lead to asymmetrical distribution of the costs of their implementation. As a result the EU budget (beside regulatory solutions) **determines adaptive capacities of the states and regions** where costs of adjustments to decisions made at the Community level are the greatest. As a result the Union avoids setting out goals based on the smallest common denominator.

The EU member states independently undertake actions leading to provision of various public goods (such as ensuring security of EU citizens, energy security and food security, dissemination and protection of European values worldwide). Simultaneous performance of actions may lead to lack of cohesion between them. The EU budget is an instrument serving the purpose of **avoiding duplication of efforts**. Similarly to co-financing, coordination of activities helps enhance cohesion of undertaken efforts, but (in contrast to co-financing) it does not reduce fixed costs borne separately by each member state.

EU states and regions are characterised by various degree of infrastructure saturation (transport, environment protection, business environment). Thus investments in infrastructure in states and regions with relatively low level of accumulated capital are usually distinguished by higher marginal utility. In the areas (such as: environment protection or expansion of transport networks), characterised by spill-over effects and externalities as well as inter-regional and inter-state differences in marginal utility of investments, it is in the interest of states and regions attaining lower marginal utility to finance investments in states and regions of higher utility. Through deployment at supraregional and supranational level, **the EU budget constitutes a mechanism enhancing utility of the allocated spending**.

Effectiveness should be also achieved by integrating those undertakings which single member states find difficult to deploy and which are at the same time significant in regional, European and global dimension, thus contributing to **synergy** of efforts presently dispersed and to attainment of the desirable **scale effect**.

For those reasons the trend to reduce the budget size may entail a risk of weakening the ability to determine and effectively deploy Community goals (including new goals). The mechanisms for coordination of national policies and regulations at the Community level do not warrant efficiency of their deployment and - as a result - of the attainment of the European value added (because they leave out the problem of costs related to deployment of goals jointly set out). The EU deprived of the instrument of common budget would have to either approve of persisting discord between the level of declared ambitions and the achieved results, or permanently lower the level of expectations.

Rejection of the idea of Community financing may in extreme cases threaten the hitherto achievements of the European integration process. A permanent introduction of **co-financing**

**of direct payments for farmers from national budgets** would be a good example of a threat for delivery of European value added. Real costs of running agricultural policy for the entire system of EU public finance (national budgets + EU budget) would not go down, whereas the more affluent countries would bear higher costs. Co-financing would create a threat for maintenance of the common market for food products, would reduce the capacity of catch-up member states to increase the level of public investments, and thus lengthen the process of full convergence.

Among criteria for assessment of the impact of EU budget spending on effective actions in accordance with the European value added principle, one should point to:

- Impact on provision of incentives for deployment of jointly determined goals (including targeting of public spending, also at the national and regional level, at goals specified at the European level),
- Impact on adaptive capacity of the states and regions whose costs of adjustments to decisions made at the Community level are the greatest (asymmetrical cost distribution),
- Impact on avoiding duplication of efforts made in many member states,
- Impact on improving utility of the spending made in relation to spending made at the national level

### ***5. Could the transparency and accountability of the budget be further enhanced?***

The public finance system in the EU would be much more transparent and comprehensible for citizens if EU budget spending was presented against the background of burdens imposed on public finance systems of the member states and on consumers and entrepreneurs. Firstly, the EU budget is responsible for about 2% of public spending borne in the EU. Secondly, not all European policies that require financing are reflected in the EU budget. As a consequence, attainment of the goals that the Union sets for itself is made not only through financing from the EU budget but also thanks to funding expended in the frames of national public finance (i.e. general government sector), or even finance of household sector (i.e. consumers) and sector of undertakings. One can imagine shifting of European policies financing between the EU budget and national budgets and changes in the level of burdens for consumers and producers.

If we put spending of EU budget on CAP and R&D policy in a broader context, it turns out that as early as in 2005 more money was spent on R&D policy than on CAP in Europe. This follows from the fact that actors shaping policy within the European Union (member states, Community institutions) reached a political agreement stipulating that the EU budget plays the key role in financing of agriculture, whereas expenditure on B&R is financed from national public finance.

When assessing the level of spending on CAP it must be pointed out that in 2005 approximately 0.39% of EU GDP was allocated to this policy from the EU budget. However, according to the agreement reached during negotiations on the financial perspective for the years 2007-2013, this amount will be gradually reduced to reach the level of 0.3% of EU GDP in 2013.

Placement of EU budget spending in a broader context of European public finance shall lead to a greater transparency of its objectives.

Transparency of EU activity is one of key aspects of relations with citizens of a united Europe. If we want to improve **credibility** of the EU budget we should introduce the obligation of accountability understood as provision of access to detailed information about beneficiaries of individual EU policies for broadly understood public opinion. This shall translate into publication of data on beneficiaries of all available EU financial sources: grants, European funds, Union programmes, public contracts as well as direct payments and second pillar of CAP. This information should also concern beneficiaries of EU external policy (neighbourhood policy, development policy).

The data should be universally available to citizens and posted for example on websites of European institutions. A model solution is the creation of a single database with full access for EU citizens. Such statistics should be presented in a way that enables their comparisons. The situation where member states refuse to provide access to data about beneficiaries of Community funding is not conducive for accountability of the spending of budget resources. However, as an institution responsible for execution of the budget, the European Commission should be aware of its responsibility to publish the said information.

In the spirit of **transparency** of Community funds spending, one should support such initiatives as establishment of the *Code of Conduct for Interest Representatives*. Creation of equal frameworks for operations of lobbying groups in the financial decision-making process in the EU seems to be a fundamental stage on the road to implementation of the rules of impartiality and fairness.

Publication of data about beneficiaries of all forms of EU activity related to spending of Community funding serves the purpose of improving transparency of budget spending.

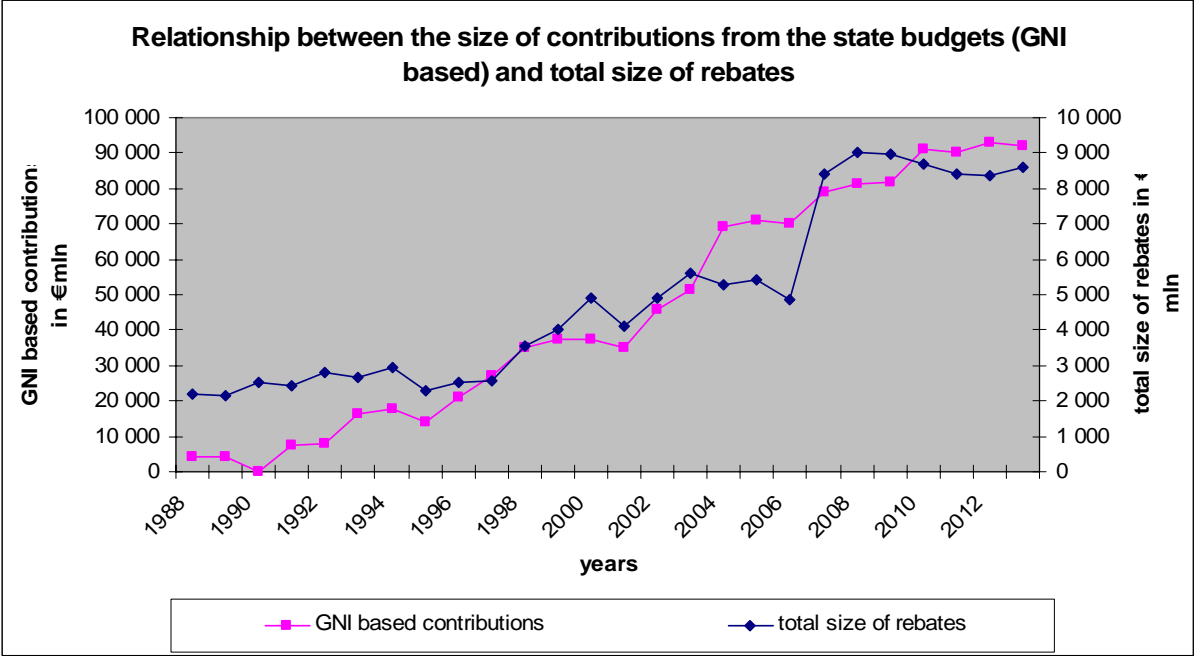
Introduction of uniform rules for functioning of lobbying groups reinforces the principles of transparency and accountability of the decision-making processes related to spending of funds from the EU budget.

## ***6. Is there any justification for maintaining correction or compensatory mechanisms?***

One should aim at removal of all mechanisms and rebates from the EU own resources system. In 1988 almost 30% of the EU budget resources came from customs duties and agricultural levies (traditional own resources being genuine own resources of the EU budget), while only 11% came from contributions of member states based on Gross National Income. In 2013 contributions from member states based on GNI will constitute as much as 75% of all resources of EU budget.

An opinion has been expressed many times that own resources system based on GNI-based payments is not only the simplest but also the fairest one. Linking budget contributions to GNI is supposed to ensure connection between contribution level and affluence of the member states and their citizens. However, practice of the operation of own resources system proves that growth of payments into the EU budget based on GNI leads to a result contradictory with the one intended – relative encumbrance with contributions to the budget from less affluent states go up.

This is so because an increase of contributions to the EU budget based on GNI reinforces the pressure on increasing the total size of rebates granted to most affluent member states. Own resource based on GNI deepens unjust own resources system ensuing from *juste retour* logic.



As a result, while tax systems in almost all member states are of progressive character, i.e. they impose the largest burdens on the wealthiest tax-payers, as a result of the applied correction mechanisms the Community own resources system is of degressive character, imposing greater burdens on less affluent member states and citizens. As an example in 2006 the contribution paid by the 8th wealthiest member state was the lowest in relation to GNI (0.54% GNI). At the same time the contribution paid by the 23rd wealthiest member states amounted to 0.89% GNI. Degressive character of own resources system results from existence of rebates.

Moreover, correction or compensatory mechanisms lead to results weakening other policies financed from the EU budget:

Correction mechanisms on revenue side are not in any way linked to activity benefiting attainment of Community objectives, and in some cases they promote lack of activity in the area of implementing projects co-financed from the EU budget. Acquisition of funding from the EU budget on the spending side as a rule entails significant organisational and institutional efforts, securing of significant national co-financing and targeting spending at Community goals (control of spending eligibility), whereas correction mechanisms on the revenue side do not require any activity on the part of beneficiaries; moreover they can largely result from defaults or lack of effective implementation of projects with European dimension.

As a result of application of correction mechanisms, the Community own resources system is of degressive character, to a larger extent encumbering the least affluent member states and citizens.  
 An increase of contributions into EU budget based on GNI resource reinforces the pressure

on increasing the total size of rebates granted to the most affluent member states.

## **7. What principles should underpin the revenue side of the budget and how should these be translated in the own resources system?**

Financing of the EU budget should be based on 3 principles:

- The method of EU financing should reflect the state of harmonisation of individual policies within the EU. The economy entities and sectors that derive the greatest benefits from European integration should bring the biggest contributions into EU budget financing.
- The present partial financing of the EU budget with receipts from customs duties and agricultural levies is a natural consequence of the Common Customs Policy and Common Agricultural Policy. Therefore one should continue the works enabling identification of subsequent autonomous own resources reflecting progress in the scope of for example liberalisation of the movement of goods, services, and capital or development of the European Economic and Monetary Union. Analytical works should also encompass improvement of the efficiency of the existing VAT own resource, which should be maintained until the time of a potential reform. One should also consider decreasing the amount of receipts from Traditional Own Resources retained by the member states as costs of collection. Therefore Poland sees a need to perform further research on possibility of developing own resource system and preparing financial analyses of potential solutions. Eventually one should aim at basing the EU budget on EU own resources in line with Article 269 of the Treaty.
- Until establishment of a complete system of budget's European financing sources, the current own resources must be supplemented with payments proportional to GNI. Therefore this transitional financial system should reflect the economic development level of individual member states, and should be transparent for citizens. One should avoid any mechanisms complicating the system and introducing privileged positions for selected member states.
- The third criterion for assessment of the revenue side should be the rule of *fairness*, which will let encumber the member states and citizens (which reflects dual legitimisation of the EU) proportionally to the level of affluence.

One should continue works enabling identification of subsequent autonomous own resources. New autonomous own resources should be derived from deepening of the European integration in individual areas, e.g. in the scope of liberalisation of the movement of goods, services, and capital or development of the European Economic and Monetary Union, with respect for the rule of fairness of burdens in relation to the level of affluence.

## **8. What should be the relationship between citizens, policy priorities, and the financing of the EU budget?**

The rules of EU budget financing may not be permanently in conflict with treaty objectives, particularly those set forth in Article 158, which stipulates that the Community shall develop and pursue its actions leading to the strengthening of its economic and social cohesion.

The system of EU own resources should reflect the deepening level of European integration and introduced institutional changes. In particular the growing role of the European Parliament in shaping the EU budget, as reflected in treaty changes, may lead to a conflict of interests with member states if the EU finance system is permanently based on GNI-derived contributions. For the above reasons, financing of the Community budget should be to a greater extent based on entities benefiting from single market freedoms, and from deepening economic and monetary integration, and to a lesser extent it should be based on direct financing from national budgets. Thus development of Community policies would contribute to expansion of the base of the system of EU own resources.

The rules of EU budget financing must not be in conflict with the treaty-derived goal of aiming at economic and social cohesion.