THE FINANCES OF THE EUROPEAN UNION

No. 58, December 2007

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Foreword

The Advisory Council on International Affairs (AIV) produced the present advisory report on its own initiative. This was prompted by the decision taken by the European Council in December 2005[1] to undertake a general review of the EU's revenue and expenditure in 2008-2009.[2] The AIV had already stressed the importance of this issue in an earlier advisory report, entitled *Europe: a priority!*[3]

This report was prepared by the European Integration Committee (CEI) chaired by Professor F.H.J.J. Andriessen. For the purpose of this report, the CEI formed a mixed working group chaired by C.G. Trojan (a member of the CEI). The other members were H.J. Brouwer, Professor J.Q.T. Rood (both members of the CEI) and E.P. Wellenstein (a member of the Peace and Security Committee). Additional assistance was provided by M.G. Bos, Deputy Director of Economic Affairs at the Social and Economic Council, and by Professor F.H.J.J. Andriessen, acting as a corresponding member. The civil-service liaison officers at the Ministry of Foreign Affairs were C. van Rij, the Director of the European Integration Department, and C.J. Bansema, the head of the Internal Affairs Division at the same department. Their expert advice was also sought by the working group. The executive secretary was dr S. Volbeda, who was assisted by two trainees, M. Breedveld and S. Çoker.

In preparing the report, the working group consulted a number of experts listed in Annexe I. The AIV is most grateful to them for their willingness to share their knowledge and views with the working group.

The AIV adopted this report on 7 December 2007.

1 *Presidency Conclusions of the Brussels European Council*, 15-16 December 2005, 15914/05. See conclusion 6, in which the Council adopts the Presidency's proposal as set out in: Presidency of the European Council, *Financial Perspectives 2007-2013*, Brussels, 19 December 2005, CADREFIN 268, document no. 15915/05.

2 See also the *Interinstitutional agreement of 17 May 2007 between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management*, OJ C 139, 14 June 2006, p. 1.

3 AIV advisory report no. 52, *Europe: a priority!*, November 2006: see Chapter II.

Executive summary

In preparing this report, the AIV was guided by the wording of the request the European Council made to the European Commission in December 2005, i.e. to:

> *'perform a full, comprehensive and wide-ranging review with regard to all aspects of EU expenditure, including the Common Agricultural Policy (CAP), and its revenue, including the British rebate, and to report on its findings in 2008-2009.'*

The AIV took as its starting point an advisory report entitled *Europe: a priority!*, which it published in November 2006.

The first part of the report contains a brief review of the system of own resources in relation to the EU's spending policy. The conclusions drawn by the AIV are fully in line with those drawn in the earlier report referred to above. Since the system of own resources was 'derailed' in 1984, the British rebate is still in force. Moreover, a constant stream of amendments (most recently in 2006) has turned the system into an extremely complex and opaque patchwork of corrections and exceptions.

The negotiations on the EU's multi-annual financial framework (known as the *Financial Perspectives*), as well as the talks on the annual budgets, have been increasingly dominated by the way in which the EU is funded by the member states. The term 'net contribution' is used to describe the difference between the amount each member state pays the EU and the amount it receives from the EU. This issue has been a source of fierce argument and has undermined discussion on EU's spending priorities. The AIV already noted on a previous occasion that this has encouraged the general public, particularly in the Netherlands, to regard EU membership primarily in terms of the size of their country's net contribution. Against this background, the AIV has a number of critical comments to make about the budgetary imbalances, the member states' net positions and the method used by the Netherlands for calculating its net contribution.

The AIV's evaluation shows that, because of the British rebate and the way it is funded, the budgetary imbalances originally stemming from the expenditure side have been transferred to the revenue side. This has severely disrupted the own resources system and paved the way for the predominance of the principle of 'fair returns'. For this reason, the AIV believes that the first priority in assessing the issue of the budgetary imbalances is to analyse expenditure policy. Both the historic trend and the criteria used for assessing expenditure policy are key points in this regard.

On this basis, the AIV believes that there are grounds for reviewing the CAP. More particularly, a stronger link needs to be made between the payment of income support and the upholding of social values, and the member states should be willing to co-fund income support. The AIV also believes that, alongside other desirable reforms, there are good reasons for concentrating convergence support (part of the cohesion policy) on the poorer member states, notably those states whose per capita gross national income (GNI) is less than 90% of the average per capita GNI for the EU as a whole, known as the GNI^{EU}. These measures will gradually reduce the proportion of the budget that is spent on the CAP and cohesion policy, and free up resources for spending on policy to strengthen the EU's competitiveness and on the EU's external policy. They should also create an opportunity for compensating for the remaining budgetary imbalances on the expenditure side.

At the same time, it is clear that a review of expenditure policy will not immediately resolve the problem of the budgetary imbalances: a correction mechanism will continue to be needed for the time being. However, this mechanism will need to be general, transparent and of limited scope (i.e. it should apply only to excessive imbalances). The AIV believes that these compensations should be paid on the expenditure side of the budget. On the other hand, if expenditure policy is adjusted as the AIV recommends, the value of the compensation, and eventually the need for paying it, should decline. The European Commission's 2004 proposals are a useful first step on the road towards this type of general correction mechanism.

As regards the EU's revenue, the AIV examined the options available to the EU for raising its own tax-based revenue. In particular, the AIV discussed the possibility of generating own resources from energy consumption, VAT and corporation tax. Its conclusion is that, for technical and political reasons, there is no likelihood of agreement being reached in the medium term on a completely new system of tax-based own resources. In the light of the foregoing, however, the AIV does believe that the current system of own resources should be rationalised so that corrections are henceforth effected only on the expenditure side.

Having said this, it would still be preferable for the EU to be allocated resources that by definition fall outside the scope of national budgets. Indeed, this was the original idea behind the system of own resources. This is the only way in which the EU can have a stable budget, the size of which does not depend on budget talks in the member states.

This is in line with the recommendations made by the AIV in its previous report. The risk inherent to the current system, after all, is that EU policy is overshadowed by the debate on the size of net contributions that has dominated the past few decades. A review of expenditure policy and the introduction of a general, limited correction mechanism that applies to all member states could solve the problem in the medium term.

In the longer term, the AIV believes that the door should be kept open to a system of own resources that by definition does not draw on national budget allocations.

I Introduction

Article 269 of the *Treaty establishing the European Community* forms the basis for the EU's system of own resources by which its expenditure is funded. This article reads as follows:

> *'Without prejudice to other revenue, the budget shall be financed wholly from own resources.*
>
> *'The Council, acting unanimously on a proposal from the Commission and after consulting the European Parliament, shall lay down provisions relating to the system of own resources of the Community, which it shall recommend to the Member States for adoption in accordance with their respective constitutional requirements.'*[4]

Under the terms of the *EC Treaty*, better known as the *Treaty of Rome*, the Community adopted a percentage-based formula for collecting budget contributions from the various member states, just as any conventional international organisation might have done. However, the Treaty provided that in the future these percentage-based contributions were to be replaced by the EU's own resources. This was the reason for introducing the Common Customs Tariff (CCT), a tax charged by all the EU's member states on incoming goods as they entered their territories. When the EU ratified the CCT under the *Own Resources Decision* (adopted in 1970), it was decided to supplement this source of revenue with new common levies on agricultural imports from non-Community countries. In order to ensure that the Community's revenue matched its expenditure (under Treaty law, the EU is not entitled to run up a deficit on its budget and is not allowed to borrow on the money markets), any shortfall was made up by stipulating that the member states should contribute a given percentage point of their VAT revenue. Initially, this figure was set at a maximum of 1%. The amount of income the EU has received from its traditional own resources, i.e. import duties and agricultural levies, as well as VAT payments, has gradually declined over time. The maximum percentage of VAT payments (known as 'VAT mobilisation') has gradually fallen in recent years, after peaking at 1.4% in 1985, and now stands at less than 0.5%.

Since the publication of the 1988 *Own Resources Decision*, the main categories of the EU's medium-term expenditure have been laid down in the form of a financial multi-annual framework, which also imposes a maximum limit on the size of the EU budget, expressed as a percentage of GNI^{EU}. This framework, known as the *Financial Perspectives*, is ratified by an Interinstitutional Agreement (IIA) signed by the European Parliament, the Council and the Commission. This must be a unanimous decision on the Council's part. Since 1988, these agreements have always been accompanied by a review of the *Own Resources Decision*. A fourth resource was recently added to the three resources referred to above, i.e. the GNI component. It is now by far the EU's largest source of revenue. The maximum amount of revenue received from the own resources collectively has been set at 1.24% of GNI^{EU}. The maximum total expenditure, as set out in the current *Financial Perspectives*, is less than 1% of GNI^{EU}; this is merely a fraction of the aggregate collective expenditure by

4 *Treaty establishing the European Community*, 25 March 1957, Treaty Series 1957, pp. 74 and 91. The treaty is also known as the *Treaty of Rome*, after the place where it was signed by Belgium, Germany, France, Italy, Luxembourg and the Netherlands. The *EC Treaty* came into effect on 1 January 1958.

the member states, which represents between 30 and 50% of each member state's GNI. The total cost of the EU is no more than 260 euros per person per year, or 70 eurocents per person per day.[5]

The current system of own resources is a distant cry from the system originally envisaged by the *Treaty of Rome*. The idea at the time was to create an own income for the EU that would not be dependent on the annual budget negotiations in the member states. The current system is extremely untransparent, especially for the citizens of Europe, and has also grown more complex over the years. The combination of national budget contributions, multi-annual *Financial Perspectives* and the need for unanimity when the Council takes decisions, has also led to inefficiencies in the allocation of expenditure.

The talks on the *Financial Perspectives* and own resources have gradually come to be dominated by the method of funding, i.e. the member states' net contributions. This trend was initiated by the correction mechanism agreed for the UK at the Fontainebleau European Council[6] in 1984.[7] Although the British rebate still remains in place at the time of writing in 2007, a constant stream of amendments[8] has seen it evolve into a thoroughly opaque and complex patchwork of multiple corrections and exceptions. To add to the confusion, some corrections are made through the revenue side of the budget, whilst others are made through the expenditure side. This situation has persisted despite the fact that, in 1999, the European Council asked the Commission to design a new system of own resources that '*should be equitable, transparent, cost-effective and simple*' and '*must be based on criteria which best express each Member State's ability to contribute*'.[9]

In 2004, the Commission presented a proposal for a new system of own resources.[10] This proposal included a general correction mechanism and three options for ways in which the EU could levy its own resources. The proposal was abandoned. Once again, the subsequent negotiations centred on further corrections to and exceptions from the existing correction mechanism.

5 European Commission, DG Budget, *EU budget 2006 Financial Report*, 2007, p. 8.

6 See Fontainebleau European Council, *Presidency Conclusions*, Bulletin of the European Communities 6-1984.

7 AIV advisory report no. 52, *Europe: a priority!*, November 2006, p. 10.

8 The Own Resources Decision was most recently amended in 2006: *Proposal for a Council Decision on the system of the European Communities' own resources (issued under Article 248, paragraph 4, second paragraph of the EC Treaty)*, OJ C 203/50.

9 *Presidency Conclusions of the Berlin European Council*, 24 and 25 March 1999, see decision 67.

10 European Commission, Report of the Commission Volume I, *Financing the European Union, Commission report on the operation of the own resources system*, COM(2004) 505 final/2, Brussels, 6 September 2004 (Schreyer proposals), and Volume II, Technical Annex, *Financing the European Union, Commission report on the operation of the own resources system*, COM(2004) 505 final, Brussels, 14 July 2004. See also European Commission, *Proposal for a Council Decision on the system of the European Communities' own resources and Proposal for a Council Regulation on the implementing measures for the correction of budgetary imbalances in accordance with Articles 4 and 5 of the Council Decision of (..) on the system of the European Communities' own resources*, Brussels, 14 July 2004, COM(2004) 501.

Despite this, the European Council did agree in December 2005 to undertake a general review of the EU budget. The Commission was asked to '*perform a full, comprehensive and wide-ranging review with regard to all aspects of EU expenditure, including the CAP, and its revenue, including the British rebate, and to report on its findings in 2008-2009*'.[11]

As a first step, the Commission recently initiated a public consultation by publishing a paper raising various points and questions in relation to both expenditure and revenue.[12] However, the Commission's consultation paper is very brief and does not discuss the issue of any possible new own resources on the revenue side, pointing instead explicitly to the sovereignty of individual member states in tax matters. This is, of course, hardly surprising, given that the current political priority is to ensure that the *EU Reform Treaty*[13] is signed and ratified. This will be followed soon afterwards by the elections for the European Parliament and the appointment of a new European Commission. In short, this is a setting that is hardly conducive to a comprehensive, ambitious reform of the system by which the EU is funded.

At the same time, the AIV believes that the time is ripe for undertaking a more fundamental reform of the EU's finances, on both the expenditure and the revenue sides. This is because the current system has been a constant source of fierce disputes among the member states and has made it difficult for the EU to set spending priorities.

The EU's spending policy is not sufficiently judged on its added value for the EU as a whole; rather, it is regarded primarily in terms of the differences in the net positions of the various member states. The 'net contribution' is the difference between the amount a member state pays the EU and the amount it receives from the EU.[14] The AIV has already stated on a previous occasion: '*In the Netherlands, the meaning of EU membership often appears to be narrowed down to the country's net contribution and the costs associated with the multiple meeting places of the European Parliament*.'[15] This narrow view distorts the true picture, and is a one-dimensional caricature of Dutch interests in the EU. The AIV therefore believes that, in order accurately to assess Dutch interests and priorities, a balanced view needs to be developed of the role played by the EU budget in the process of European integration.

11 *Conclusions of the European Council*, 15-16 December 2005, 15914/05. See Conclusion 6, in which the Council adopted the Presidency's proposal as set out in: Presidency of the European Council, *Financial Perspectives 2007-2013*, Brussels, 19 December 2005, CADREFIN 268, document no. 15915/05, p. 32. This decision was formalised in the *Interinstitutional agreement of 17 May 2007 between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management*, OJ C 139, 14 June 2006, p. 1.

12 European Commission, *Reforming the budget, changing Europe*, a public consultation paper in view of the 2008/2009 budget review, SEC (2007) 1188 final, Brussels, 12 September 2007. The consultation runs to 15 April 2008 at the following email address: budget-review@ec.europa.eu.

13 Conference of the Representatives of the Governments of the Member States, *Draft Treaty amending the Treaty on European Union and the Treaty establishing the European Community*, CIG 1/1/07, REV 1, Brussels, 5 October 2007.

14 For the latest list of net contributions, see: European Commission, DG Budget, *EU budget 2006 Financial Report*, 2007, pp. 19 ff.

15 AIV advisory report no. 52, *Europe: a priority!*, November 2006, p. 9.

The AIV feels that, in addressing the reform of EU finances, it is worth focusing first on the EU's spending policy. This is because the budgetary imbalances stem mainly from the expenditure side of the budget. The AIV will go on to discuss possible improvements on the revenue side.

The two main questions the AIV wishes to raise in this report are:

1. *What changes are required in the EU's pattern of spending?*
2. *What improvements or fundamental alterations are needed in the EU's revenue in order to produce a balanced budget?*

The AIV stresses that the first question, about spending priorities, can be answered only by taking the entire gamut of the EU's policy objectives and policy tools into consideration. This is because, apart from the budget itself, legislation is often a highly effective tool by which the EU can achieve its objectives. In addition, the Union has its own role and responsibility in the world, which it can strengthen by means of international negotiation, or 'soft power'. In other words, the EU budget is by no means the Union's most powerful policy tool. The budget is not a steering tool, but rather a tool for supporting the EU's policies. Moreover, every time it is used, the Union must decide whether the principle of subsidiarity requires European rather than national action.

This report is based on an assumption that any changes in the EU's spending policy should not raise the financial burden placed on the shoulders of European citizens. The European Parliament and the European Commission take the same view, because the ceiling of 1.24% of GNI^{EU} has proved to be more than sufficient in practice, with the actual figure consistently remaining under 1% of GNI^{EU}. With the national income set to grow in the future, it is safe to assume that this bandwidth will remain practicable for the time being.

As far as the second question is concerned, it is clear that, even in the case of a very small budget such as that of the EU, revenue must be generated to balance expenditure. The following analytical framework applies here.

Analytical framework

In more general terms, three fundamental questions need to be raised in assessing policy and the use of financial (and other) tools:[16]

1. *Expediency:* Is there a problem? In accordance with the principle of expediency, no action may be taken if the issue is not perceived as being a problem, or if government action cannot actually improve the situation.
2. *Subsidiarity*: At what level should the problem be resolved, i.e. should it be resolved by an individual member state at national level or by a subnational government body; should it be tackled on an EU-wide basis; or should it be handled by an international organisation? In accordance with the principle of subsidiarity, the EU may take action only if and in so far as the member states are not sufficiently capable of achieving the objectives the proposed action is intended to achieve.
3. *Proportionality*: Is the proposed action effective? Does it offer any added value? Is it not excessive given the nature of the problem? The proportionality principle states that the form and contents of EU action may not be more than what is needed to achieve its objectives.

16 See in this connection Advisory Council on International Affairs advisory letter no. 10, *The European Union and its relations with Dutch citizens*, December 2005.

The first question to ask, therefore, is whether government action is actually required. The EU's chief object is to create a single internal market. Although a single market has not yet been created for all goods and services, most individual markets are now operating much better than during the first few decades of the EU's existence. In other words, not taking any action is clearly an option. The same fundamental question needs to be asked in relation to other policy areas.

If it is clear that the social benefits of government spending are greater than the costs, the next step is to decide on the most appropriate administrative level at which to intervene. Before this judgement can be made, an assessment needs to be made of the costs and benefits of centralisation. The benefits consist of economies of scale and/or cross-border benefits (or the prevention of adverse external effects). The costs consist of the loss of opportunities to take advantage of national, regional or local differences in preferences, greater diversity and competition in the supply of public goods and services, and a more direct link between the benefits of public expenditure and the funding costs.

Generally speaking, government action is desirable if the social benefits of action are greater than the social costs. This is the basic principle applied in explicit cost-benefit analyses of individual projects, for example by the Netherlands Bureau for Economic Policy Analysis. However, it may also be applied to more general analyses, such as an analysis of the financial reform of the EU.

The second question concerns the administrative level at which a particular task can best be performed. Here, action taken at European level needs to be compared with action taken at a higher (i.e. global) or lower (i.e. national, regional or local) level.

The third question focuses on whether government action is justified and, if so, in what form. Should action be taken on the expenditure or income side of the EU budget, or would legislation or diplomacy be more effective?

In concrete terms, the above principles may be translated into the following questions for policymakers:

- Are there grounds for taking government action, in that the social benefits are likely to be greater than the social costs?
- Are there grounds for taking action at EU level, because of failing market forces or because there is a need for redistribution at European level?
- If so, what are the options for the form which the action should take? Is a form of intervention on the expenditure or revenue side of the EU budget the most appropriate tool, or would legislation or diplomacy produce a better solution?

This requires an analysis of the costs and benefits in each policy area, which may yield various results in different fields.[17] For example, it must be possible to adapt spending policy to changes in circumstances, which means that it must be sufficiently flexible to support new policy priorities.

17 One problem in assessing the EU's expenditure is that no comparative data are available on its effectiveness, at either EU or national level. The Netherlands Court of Audit recently studied a large number of evaluations of EU expenditure. Whilst they paint a picture of outputs, i.e. what has been done with the money, they fail to establish whether or not spending has had an impact in terms of achieving objectives. In many cases, the objectives are not expressed in terms that enable clear impact measurement. Moreover, the evaluation methods used are too divergent to enable proper comparisons to be made. See Netherlands Court of Audit, *EU Trend Report 2007*, The Hague, 20 March 2007, Chapter 6.

A few examples.
1. The need to strengthen Europe's competitiveness and bolster economic growth are both high-priority items on the EU's agenda. The question is how and where the EU budget instrument can play a relevant role in this respect, and what sort of changes can be made in the budget to accommodate these key policy fields.
2. The cohesion policy has borne fruit and it has gained a new dimension in the wake of the EU's enlargement to 27 member states. Although no one denies that the relatively rich countries are duty-bound to show solidarity with the poorer countries, it is not clear whether spending on disadvantaged areas in the richer member states should be regarded as an EU issue.
3. The nature of the CAP has changed dramatically over the years. When the policy was first launched, it made sense for the EU to fully fund market and price support to replace a multitude of national support measures. Today the question is whether the current income support system is as self-evident.
4. The financial tools of the EU's external policy are part of the EU's 'soft power', and most of them replace earlier national measures. The question is therefore how the EU's role as a global player should be expressed in the budget.

All these questions are addressed in the remainder of this report. Chapter II begins by analysing the problems outlined above. More specifically, it contains a detailed discussion of the significance of the budget instrument in the EU's overall policy, the budgetary imbalances, political interest in net contribution, and the way in which they are calculated by the Netherlands. These analyses form the basis for the solutions subsequently presented in the report.

Chapter III centres on changes in the EU's spending policy. Any changes need to be gradual and will therefore be time-consuming. The same applies to the issue of a mechanism to correct budgetairy imbalances: it will take time to eliminate. Nonetheless, there is an urgent need for a transparent, equitable and simple correction system that can be adopted across the board in all member states.

Chapter IV discusses the revenue side of the EU budget. In the light of recent developments and applying criteria of adequacy, stability, efficiency and equity, the AIV seeks to identify practical options for both the short and the medium term. In doing so, it examines the possibility of new own resources. Any new system of own resources is bound to be difficult to implement, in both political and practical terms.

The conclusions and recommendations presented in Chapter V explicitely take a closer look at the external factors and the political feasibility of certain options. The AIV is fully aware that any fundamental reform of the finances of a European Union consisting of 27 member states will be time-consuming and may spark fierce political arguments. By definition, it can only be implemented gradually. Whilst the AIV is bound to view the reform of the EU budget from a Dutch perspective, it has done its best not to lose sight of the interests of Europe as a whole.

II Critical comments on the EU's current Financial system

What is actually wrong with the financial system currently used by the EU? Why do so many corrections need to be made? The principle of expediency requires us first to establish whether there is a problem that warrants a change of policy. In order to answer this question, the AIV analyses the problems outlined in the Introduction. The AIV has critical comments to make on the importance of the budget as a policy tool for the EU, and discusses the budgetary imbalances, the concept of net positions and the way in which they are calculated by the Netherlands.

Critical comments on the importance of the budget as a policy tool
Compared with the rest of EU policy, Europe's budgetary policy is of relatively minor importance. While in most member states the national budget gives a relatively true and fair view of the government's policy priorities (such as education, social policy, security and infrastructure), this does not apply to the EU. The bulk of EU policy is after all implemented by other means than the budget instrument. The single market, the cornerstone of European integration, is a good example of this. For consumers, it means more freedom of choice. For employees, it means better opportunities to work in other countries. For firms, it means better access to larger markets. The single market is the product of the free movement of goods, services, people and capital, the freedom of establishment, the enactment of common legislation (on the protection of health, safety and the environment, among other areas) and European competition policy.

This raft of fundamental policies is primarily the result of the harmonisation of existing legislation and the enactment of new legislation. Budget resources and tax policy have very little to do with it. It has been built essentially on the removal of national laws that are discriminatory and which hamper the exchange of goods, services, people and capital among member states, on the harmonisation of laws to protect public interests, and on the mutual recognition of laws between member states. This is what constitutes the EU's core business. Other policy priorities however do require a modest amount of funding. The CAP and the EU's cohesion policy absorb the bulk of this budget. In the case of the CAP, this is chiefly because the bulk of it replaces previous national support measures. The cohesion policy, on the other hand, was devised to foster solidarity between rich and poor member states. At the same time, the relatively minor importance of the budget as an EU policy tool explains why it represents (in relative terms) a mere fraction of the national budget of any member state.

Critical comments on the budgetary imbalances
The issue of budgetary imbalances was put on the agenda more than 25 years ago at the insistence of the UK. Today, the issue still dominates not just the negotiations on the multi-annual Financial Perspectives, and even the annual budget debates. The British rebate was originally agreed on the understanding that '*... a Member State bearing an excessive budgetary burden in relation to its relative prosperity may qualify for a correction in due course*'.[18] The AIV wishes to make a number of critical remarks about this.

18 Fontainebleau European Council, *Presidency Conclusions*, Bulletin of the European Communities 6-1984.

1. Now that circumstances have changed, a permanent UK rebate is no longer justified. Moreover, the rebate is itself the cause of further imbalances, given that the other member states are required to pay for it and four of them (including the Netherlands) pay less than the others in relative terms. As a result, a budgetary imbalance on the expenditure side of the budget (i.e. stemming from the high proportion of the EU budget that is devoted to agricultural spending) has now been transferred to the revenue side, thereby seriously undermining the system of own resources. The fact that the British rebate has been retained in the face of reason, and the way in which it has been funded from budget payments from the other member states, has encouraged EU governments to view the EU budget exclusively in terms of its ability to deliver 'fair returns'. The situation has been exacerbated by the unanimity rule, to which the European Council's decisions on the *Financial Perspectives* are subject.[19]

2. The EU's pattern of spending has radically altered since 1984. The UK is now one of the wealthiest countries in the Union, spending on agriculture has fallen to 41% of aggregate expenditure (2006) and 64.7% of the EU's expenditure is funded on the basis of per capita GNI, which is by definition a measure of relative prosperity. In other words, the system of own resources has evolved into a system of national budget payments. Taken together, GNI and VAT payments funded 80.6% of the EU's aggregate expenditure in 2006.[20]

3. The rebates paid on national contributions help to spread the common misconception that the imbalances stem from the system of own resources. These imbalances, expressed in terms of net contributions, are in fact caused by the geographical distribution of expenditure.

On the expenditure side of the EU budget, spending in the Netherlands accounts for only a small share of the amounts allocated to individual member states (i.e. 2.3% in 2006). This is largely due to the fact that the Netherlands accounts for only a small proportion of agricultural spending (i.e. 2.5%) and structural expenditure (1.4%). These two items of expenditure together account for almost 85% of all expenditure allocated to individual member states.[21]

Critical comments on the net contributions

Since the early 1990s, a country's net position relative to the EU budget has often been used as the main pointer to show whether it has either 'won' or 'lost' in EU negotiations. Tellingly, the Dutch government decided to include four tables and two graphs on this particular point in the State of the Union for 2008.[22] The AIV believes that, for a number of reasons, far too much weight is attached to this indicator.

19 The unanimity rule is not contained in the *Treaty of Rome*, but was introduced in 1966, when it was also known as the 'Luxembourg Compromise'. See in this connection: Jacques Le Cacheux, Funding the EU Budget with a Genuine Own Resource, The Case for a European Tax, *Notre Europe Studies*, 57, May 2007, p. 8.

20 European Commission, DG Budget, *EU budget 2006 Financial Report*, 2007, pp. 11 and 30.

21 This is all expenditure, with the exception of spending on external policy and administration. See European Commission, DG Budget, *EU budget 2006 Financial Report*, 2007, calculated on the basis of the figures in the table on p. 61. This table has been appended as Annexe III.

22 *State of the Union 2008*, The Hague 2007, pp. 92-95.

1. The net financial position describes nothing other than the balance of income and expenditure relative to the EU budget; it does not say anything about the value of the single European market for the Dutch economy and even less about the value of European integration for the Netherlands in general.

2. The distribution of EU expenditure over the member states paints a distorted picture of the distribution of the benefits of this expenditure. For example, spending under the cohesion policy to improve the infrastructure in a particular country primarily benefits the country in question. However, if any foreign companies are involved in the implementation of the policy, they too benefit from it. Ultimately, therefore, some of the money often ends up in another country. The effects of this policy – such as better roads and railways – do not simply benefit users in the country in question, but also users from other countries. The modernisation of Spain's road network is a good example: the roads in Spain are used not just by the Spaniards themselves, but also by haulage firms from all over Europe as well as millions of tourists every year. In short, it is far more difficult to accurately attribute the benefits of the EU's expenditure than is suggested by the annual figures produced by the European Commission on expenditure in a given member state.[23]

3. The same is true of the CAP. Here too, criticisms could be levelled at the way in which the net contribution is used to indicate whether a country has either 'won' or 'lost out' in EU negotiations. In economic terms, the switch from market and price support to income support has meant shifting the financial burden from consumers to taxpayers. Although this has not made much difference to ordinary citizens, it has led to major changes in the net contribution positions of individual member states. The Netherlands became a net payer instead of a net beneficiary as a result.[24]

Critical comments on the accounting method used in the Netherlands
The Netherlands has rejected the method used by the European Commission in calculating the net contributions of the member states, choosing to use its own accounting method instead.[25] The AIV wishes to make two critical comments about this method.

1. The Dutch government regards the agricultural levies and import duties as national resources. This is not correct, because these taxes are levied at the point where the goods in question enter the EU. As a major transit country, the Netherlands collects a relatively large amount of these taxes. Despite being known as the 'Rotterdam effect', it

23 European Commission, DG Budget, *EU budget 2006 Financial Report*, 2007, p. 63. The Netherlands is presented in this report as the largest net contributor to the EU in relative terms since 2002, the highest contributions being those made in 2005 and 2006, at 0.52 and 0.47% of GNI respectively. This is not because the Netherlands pays more than it should, but because it receives relatively little agricultural support and resources from the Structural Fund.

24 Thus silencing initial Dutch opposition to the British rebate.

25 This is described in detail in: *State of the European Union 2005-2006*, The Hague 2005, Chapter 3: The EU Finances, press copy, and *State of the European Union 2006-2007*, The Hague 2006, Chapter 2: The EU Finances, Parliamentary Paper 30802, no. 1. See also in this connection: Netherlands Bureau for Economic Policy Analysis, *Macro-economic Forecast 2006*, The Hague 2005, Chapter 6 and Social and Economic Council Advisory Report no. 98/04, *Agenda 2000: Financing and Enlarging the European Union*, 1998.

applies equally to other points of entry, such as Amsterdam Schiphol Airport.[26] It is contrary to the *EC Treaty* to regard Community taxes as national resources.[27] They are a uniform admission charge paid for goods entering the single market from outside the EU; this admission charge is generally passed on to end users, in whichever of the 27 member states they are located. Thus, the duties charged on goods entering the Netherlands actually belong to the EU. Despite this, the Netherlands still takes these figures into account when calculating its net contribution.

2. The Dutch government treats EU expenditure on EU institutions, such as the European Commission, the European Parliament and the European Court of Justice, as revenue received by the countries in which the institutions are based, notably Belgium and Luxembourg. In doing so, the Dutch government ignores the fact that the added value for the member states of the work performed by these institutions is way in excess of the local spending effects.

Incidentally, if the income from the traditional own resources is ignored, the net Dutch contribution paid in 2006 still tops the list. Once the Dutch rebate takes effect in 2009 (retroactively from 1 January 2007), the Dutch net contribution will then decrease, leaving the Netherlands in the middle of the net contributors.

26 See in this connection, for example, J.F.H. Inghelram, Welke toekomst voor de financiering van de EU? ('What future for EU funding?'), *SEW*, no. 5, May 2007, pp. 191-200.

27 The traditional own resources (including import duties and agricultural levies) are rightly ignored when calculating the British rebate.

III EU expenditure

As we already said in the introduction, EU expenditure is not an accurate reflection of the Union's policy priorities, given that the EU also makes effective use of other policy tools. In other words, EU expenditure does not fully reflect the various stages of development of the EU's integration. In the future, too, budget spending will never fully mirror the Union's policy priorities. Having said this, the AIV still believes that changes in the budget can help to resolve the problems outlined above.

This chapter focuses on the principle of subsidiarity and the proportionality of the EU's spending policy. To clarify matters, a brief outline of the history of this policy follows below. This is followed by a discussion of the new policies adopted in the wake of the *Financial Perspectives 2007-2013*. The chapter concludes with recommendations for improvements in the spending policy in relation to the various policy areas covered by the EU budget. These are:

1. the policy on the strengthening of the EU's competitiveness;
2. cohesion policy;
3. agricultural policy;
4. the policy on citizenship, freedom, security and justice; and
5. the common foreign and security policy.

The chapter ends with an examination of the budgetary imbalances and the need for a general correction mechanism.

The history of the EU's spending policy

European integration is a gradual process, and there have been a number of occasions on which unification has been accelerated by the interaction between internal dynamics (e.g. the single market and Economic and Monetary Union) and external dynamics (e.g. the 'velvet revolution' in Central Europe, German unification and the constant series of enlargements).

The policy on market and price support for agricultural produce (i.e. the CAP), which for many decades absorbed the bulk of the budget, was in fact mainly adopted as new policy to replace existing policy. The principle of subsidiarity meant there was a need to replace all sorts of existing national forms of agricultural support and protection. In the Community of six member states, the creation of a common system for funding agriculture was the result of a marriage of convenience between France and Germany that was supposed to lead to a customs union. Having built up a robust manufacturing sector, Germany was likely to benefit most from this union. In return, France insisted that its important agricultural industry should receive support. In other words, the Common Agricultural Policy (CAP) – later to become the butt of fierce criticism – was simply the price that had to be paid for the formation of a customs union. The proposal also had the advantage of being attractive at the time to the Netherlands, which was a big exporter of agricultural produce and stood to gain a great deal from a single European market.

When a common policy for the agricultural sector was first adopted, it made sense to base it on market and price support. This model was devised by the Dutch Commissioner Sicco Mansholt, who took his inspiration from the Dutch Agricultural Equalisation Fund. There was a shortage of most agricultural products among the 'Community of Six', who at the time (i.e. shortly after the Second World War) were very keen to secure their food supplies.

From the 1970s, the proportionality of this policy rightly came under fire due to the rapid grow of agricultural surpluses, plus all the expenses and other disadvantages these involved. Only when the system of market and price support was exchanged, many decades after the policy was first established, for one of income support did things finally change for the better now that the new policy no longer has any link with production levels. Despite the fact that agricultural expenditure gradually fell after 1985 as a proportion of the EU's aggregate expenditure, agricultural spending remains nonetheless high, in both absolute and relative terms. Whereas spending on the CAP (excluding spending on rural development) accounted for 70.8% of the EU budget in 1985, the figure had fallen to 35% in 2006. Agricultural expenditure will still account for one third of the overall budget in 2013.[28]

Financial 'multi-annual frameworks' have been compiled ever since 1988. The first of these, the *Financial Perspectives 1988-1992*, also known as the 'Delors 1 Package', paved the way for a sharp increase in spending on the cohesion policy.[29] One of the main agenda items during this period was the creation of a single market for the poorer countries, an objective for which the Structural Funds were used. These Funds were intended to remove the social and economic disparities between the member states (in accordance with the subsidiarity principle, this is regarded as being an EU task).

Although the Delors II Package (the *Financial Perspectives 1993-1999*) revolved around the creation of an Economic and Monetary Union (EMU), the cohesion policy remained vital. While the internal dynamics of the Union clearly had a profound influence on the EU's spending policy during these two periods, there was also heightened interest in the external dynamics during the second of them (i.e. from 1993 to 1999).[30] In other words, in both this and the previous period, the Structural Funds were used as a logical complement to the deepening and broadening of the single market.

The *Financial Perspectives 2000-2006* ('Agenda 2000') eased the way for the accession of a further ten new member states and a corresponding rise in expenditure.

The issue of net contributions again played a prominent role during the debate leading up to the publication of the current *Financial Perspectives (2007-2013)*, the emphasis in which lies more on the need to control spending than on any new priorities in the EU's spending policy. No big new funds were created in the previous *Perspectives* for implementing the Lisbon Agenda, and the situation has remained the same in the current multi-annual framework. At the same time, the Commission has succeeded in simplifying the system of expenditure, by replacing the former seven categories (i.e. Agriculture, Cohesion Policy,

28 European Commission, *Reforming the budget, changing Europe*, a public consultation paper in view of the 2008/2009 budget review, SEC (2007) 1188 final, Brussels, 12 September 2007, p. 6, and European Commission, DG Budget, *EU budget 2006 Financial Report*, 2007, p. 15.

29 These funds accounted for 10.8% of the EU budget in 1985, a figure which had risen to 17.2% in 1988. By 2013, they will take up over one third of the budget (35.7%). See European Commission, *Reforming the budget, changing Europe*, a public consultation paper in view of the 2008/2009 budget review, SEC (2007) 1188 final, Brussels, 12 September 2007.

30 Denmark, Ireland and the UK had acceded in 1973, and Greece in 1981, with Spain and Portugal joining in 1986. Austria, Finland and Sweden became members in 1995.

Internal Policy, External Policy, Administration,[31] Pre-accession and Accession, and Compensation for new Member States)[32] with five new key headings.[33] These are as follows:

1. Sustainable Growth;
2. Preservation and Management of Natural Resources;
3. Citizenship, Freedom, Security and Justice;
4. The EU as a Global Partner;
5. Administration.

This simplification was intended to greatly enhance the flexibility of spending under the various headings. In other words, it should now be easier to shift resources from one category to another under one and the same key heading. The AIV believes that this raft of measures is a major improvement, and should enable resources to be allocated more effectively and efficiently in accordance with their added value.

Allocation of resources[34]

The Commission wishes to give priority to the completion of the single market.[35] This falls under the first heading, Sustainable Growth. Most of the money involved will be spent on job creation; the budget for strengthening the competitiveness of the EU will be raised by 71% during 2007-2013, and spending on cohesion policy will also rise, by 21%. A total of €382.1 billion (in 2004 prices) has been set aside for Sustainable Growth. This heading is closely linked to the Preservation and Management of Natural Resources, for which €371.3 billion has been set aside. Sustainable Growth includes categories such as research, education and trans-European networks for strengthening the EU's growth potential, environmental protection and energy. The second heading, i.e. Preservation and Management of Natural Resources, includes agriculture and rural development, spending on which is planned to fall gradually by 8% during the period in question.

The Commission's next priority is the promotion of Freedom, Security and Justice and European Citizenship. A total of €10.8 billion has been reserved for this key heading, which covers spending on public health, the arts, justice and home affairs. The latter category includes expenditure on the fight against terrorism and organised crime, immigration and judicial cooperation. Spending on Freedom, Security and Justice is set to rise rapidly, by 163%, whereas spending on Citizenship is planned to rise by 1% only.

The Commission also wishes to give greater priority to a coherent external policy beyond the EU borders. This key heading covers spending on categories such as humanitarian aid,

31 This covers spending on the EU institutions.

32 This latter category is by definition temporary.

33 *Interinstitutional agreement of 17 May 2007 between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management*, OJ C 139, 14 June 2006.

34 The latest figures, published on 4 April 2006, are reproduced in Annexe IV: *Financial Framework 2007-2013*, Indicative breakdown of expenditure with adjusted financial envelopes after Trialogue of 4 April 2006. This is the source of the figures quoted in this section.

35 See COM(2004) 101 final of 10 February 2004 (objectives) and COM(2004) 487 final of 14 July 2004 (proposed legislation).

development policy[36] and neighbourhood policy[37], including the cost of the EU's accession policy. Spending in this area is planned to rise by 29%. In total, a sum of €49.5 billion has been set aside for the key heading 'The EU as a Global Partner'.

Finally, a separate category has been created for 'Administration', an essential item covering payments to EU institutions. Despite the Union's massive linguistic diversity, this category accounts for just 5.8% of the overall budget in 2007-2013. This makes an interesting comparison with UN institutions such as the UNDP, the UNEP and the WHO, which have far fewer official languages to deal with and whose administrative costs nonetheless take up 10% of their budgets. A total of €49.8 billion will be spent on this category during the entire seven-year period.

Based on the projected future rate of growth in the EU's income, the budget is expected to grow by 10% in total. A figure of €864.3 billion has been set for the aggregate budget for the period as a whole.

Expressed in whole numbers, the percentages set aside for the five key headings are:

Sustainable Growth:	44%
Preservation and Management of Natural Resources:	43%
Citizenship, Freedom, Security and Justice:	1%
The EU as a Global Partner:	6%
Administration:	6%

Towards a more targeted use of EU resources

In 2003, an independent study group chaired by André Sapir prepared a report entitled *An Agenda for a Growing Europe* at the request of the then President of the European Commission.[38] The study group formulated two challenges to which it said the EU should rise:

(i) the objective set out in the Lisbon Agenda of turning the EU into the most competitive and dynamic knowledge economy by the year 2010, and at the same time achieving both ecological sustainability and greater social cohesion; and
(ii) the successful enlargement of the EU with a large number of Central and Eastern European countries.

Sapir et al. recommended a profound reform of the expenditure side of the EU budget in order to achieve these two aims. The study group stressed the need to make swingeing cuts in spending on agriculture, and proposed assembling EU expenditure under three new headings, in accordance with the 'one objective one fund' principle.

1. One fund for economic growth, which should be designed primarily to promote research and development, education and training, and (cross-border) infrastructure. The study group proposed that this fund should account for 45% of spending.

36 The AIV is currently preparing an advisory report on the harmonisation of Dutch and EU development policy.

37 The AIV published a report on the European Union's new eastern neighbours in July 2005 (AIV advisory report no. 44). The EU's neighbourhood policy also covers, in addition to the eastern neighbours, the EU's neighbours on the southern and eastern coasts of the Mediterranean.

38 André Sapir et al., *An Agenda for a Growing Europe, Making the EU Economic System Deliver*, Report of an Independent High-Level Study Group established on the initiative of the President of the European Community, July 2003.

2. One convergence fund for helping the less developed member states catch up with the rest. This fund would be devoted to institution-building and investments in the physical and human infrastructure. The study group suggested earmarking 35% of spending for these activities.
3. One restructuring fund for deepening and broadening the integration process. This fund should be used to help employees find new jobs, by means of retraining, the payment of relocation allowances and support in setting up new businesses. This fund, accounting for 20% of the budget, would also provide a home for the remaining agricultural support.

The main thrust of the recommendations made by Sapir and his study group is as follows:
- more EU money to be spent on the promotion of the knowledge economy;
- less EU money to be spent on agriculture;
- structural support to be concentrated more on the poorer member states;
- EU expenditure to be targeted more carefully at restructuring processes; and
- no increase in the existing budgetary resources.

The aggregate expenditure envisaged by the study group is more or less the same as the EU's current level of spending, although Sapir does not make any separate provision for Administration. This budgetary item, which relates to the operation of the EU institutions, accounts for 6% of the expenditure envisaged in the *Financial Perspectives 2007-2013* (or 0.06% of GNP^{EU}). Also, Sapir does not make any separate provision for spending on external policy, which is also assumed to take up 6% of the EU's expenditure in the same period (again, 0.06% of the GNP^{EU}). Whilst this complicates comparison, the AIV endorses the main thrust of the study group's recommendations, on the proviso that a separate budget category is created for external policy.

Spending cuts proposed by the AIV assuming that the tax burden on citizens remains the same
The AIV is not in favour of raising the existing own resources ceiling of 1.24% of GNI^{EU}, nor does it wish to change the system of multi-annual Financial Perspectives. Similarly, it does not want to see any big rises in the EU's overall level of spending during the period covered by the next Financial Perspectives, i.e. 2013-2020. The AIV wishes nonetheless to stress that the current expenditure ceiling of 1% of GNI^{EU} may by no means be regarded as excessive. What is of paramount importance, however, is that the policy pursued is of high quality and that the principles of subsidiarity and proportionality are strictly observed in this connection.

The following sections examine the changes that need to be made in the various fields of spending policy. The chapter concludes with a discussion of the correction mechanism.

1. Policy on strengthening competitiveness

Europe's growth potential depends to a large extent on the further development of the single market. Removing the barriers to the free movement of goods, services, people and capital lowers transaction costs, boosts competition, raises efficiency and encourages innovation.

Clearly, the benefits of the single market can be put to productive use only if people, goods, energy and information can indeed move freely in the European space, in both a real and a virtual sense. This is why trans-European networks are being developed. The infrastructure for international transport and communication should offer both adequate quality and sufficient

capacity, and there should be good links between the various networks.[39] The construction, maintenance and funding of infrastructural facilities are the prime responsibilities of the member states. However, policy competition between the member states in this area does not automatically lead to well-connected European networks, each of which is of sufficient quality and capacity. If there is no effective international harmonisation, there is a risk that routes and nodes will be of poor quality, thus hampering the operation of the single market and restricting the growth potential of Europe as a whole.

Recommendation 1:

> *In the light of the subsidiarity principle, the AIV urges the EU to formulate a common position on the main transport routes and nodes. This is the only way of identifying possible infrastructural problems in good time and taking full advantage of the emergence of new, innovative networks. Where substantial cross-border effects can be produced, the AIV believes that the EU should encourage these by means of cofunding, in accordance with the proportionality principle.*

Our future prosperity depends primarily on our ability to develop and use new knowledge for designing new products and production processes. For this reason, investing in the European knowledge economy is one of the priorities in the Lisbon Strategy. In this context, the EU has committed itself to raising both public-sector and private-sector spending on R&D to 3% of the EU's gross domestic product (GDP^{EU}) by 2010. This figure was 1.9% in 2005; the target figures set by the member states together amount to 2.6%.[40] Incidentally, this is the only budget item in respect of which the Netherlands receives more than it pays.

The AIV believes that there are good reasons for Europe to take a closer interest in R&D.[41] First of all, there are major economies of scale to be gained. High-quality research is becoming increasingly complex and costly; the critical mass is increasing and international cooperation is becoming more and more important. Secondly, those who benefit from investments in R&D include customers, in both the Netherlands and abroad. For example, Dutch firms are among the beneficiaries of German investments in R&D, and the opposite also applies.

Recommendation 2:

> *The single market needs to be supplemented with a European research area. This requires more money to be spent on knowledge and innovation. The AIV agrees with the recommendations made by the Sapir study group, which urged the EU to play a more active role in promoting R&D, and endorses its conclusion that far more EU budget resources need to be spent on this than the current figure of 0.05% of GNI^{EU} per annum. A redistribution of budget resources is required.*

While R&D clearly remains a national preoccupation, there is every reason, in the context of the Lisbon targets, for the EU to encourage national governments to take action in cases

39 See Social and Economic Council, Committee of Socio-Economic Experts, *Higher Growth through European Cooperation*, The Hague 2004, pp. 58-60.

40 European Commission, *Implementing the Renewed Lisbon Strategy for Growth and Jobs: 'A year of delivery'*, COM(2006) 816 final, Brussels, 12 December 2006, p. 9.

41 See Social and Economic Council, Committee of Socio-Economic Experts, *Higher Growth through European Cooperation*, The Hague 2004, pp. 161-163.

where extra funding from Brussels is required. This concerns large-scale programmes that are too costly for a single member state to fund, and involves promoting closer cooperation among existing R&D programmes. The current system of distributing resources, in which each country is allocated a given budget in advance (known as 'national envelopes'), is counterproductive, as it does not encourage R&D of the highest quality in the EU.

Recommendation 3:

In accordance with the principles of subsidiarity and proportionality, the AIV believes that the EU should foster R&D by cofunding large-scale programmes that would otherwise be unaffordable. The budget allocated for this purpose should not be distributed in advance in the form of national envelopes, but should instead be spent on projects that come out on top in international competitions.

2. Cohesion policy

The cohesion policy was created as an additional tool operating alongside the single market, to eliminate the differences in prosperity between the member states and between different regions in the member states. Although this form of solidarity has clearly borne fruit in the past, the question is whether it should be retained in its current form.

A total of €308 billion (in 2004 prices) has been budgeted for cohesion policy (including both the Structural Funds and the Cohesion Fund) for 2007-2013. Of this figure, 82% has been earmarked as convergence support for the development of poorer regions and member states. Over 2% has been budgeted for cross-border regional cooperation, and the remaining 16% is to be spent on promoting competitiveness and creating jobs in regions that do not qualify for convergence support.[42]

The cohesion policy has now been adjusted to take account of the Lisbon Strategy. This means that, in those regions that are least developed compared to the rest of the EU, at least 60% of the available budget has to be spent on activities in support of the Lisbon objectives. This minimum figure is 75% in the remaining regions. A large proportion of the convergence support is spent on poor regions in relatively rich member states; Spain, Italy and Germany (three member states whose per capita GNI is higher than the EU average) together absorb a quarter of the overall cohesion budget. The AIV takes the view that, in accordance with the subsidiarity and proportionality principles, the relatively wealthy member states should themselves take responsibility for equalising regional differences in prosperity in their own countries.[43] This suggests that, of the 15 'old' member states, only Portugal and Greece should still receive resources from the Structural Funds.

Recommendation 4:

The AIV recommends concentrating convergence support on relatively poor member states (i.e. those member states whose per capita GNI is less than 90% of the EU average).

Under the current budget system, this type of expenditure falls under both Sustainable Growth and the Preservation and Management of Natural Resources. This mixes up

42 OECD, *Economic Surveys: European Union*, Paris 2007, p. 142.

43 See in this connection Social and Economic Council Advisory Report no. 98/04, *Agenda 2000: Financing and Enlarging the European Union*, 2004, pp. 67-70.

spending on two divergent objectives, i.e. that of fostering solidarity among the member states and that of promoting economic growth. In accordance with the recommendations made by the Sapir study group,[44] a clearer distinction should be made between spending on the objectives covered by these two key headings.

Based on the principles of expediency, subsidiarity and proportionality, the AIV recommends limiting spending under the cohesion policy in the relatively wealthy member states, for example, by restricting the contribution to a maximum of 25%, as opposed to a 50% maximum contribution that would apply to the poorer member states.

The AIV believes that the cohesion policy should focus on achieving programme-based effects in order to strengthen the EU's competitiveness, and not on direct spending effects in individual member states. This would help to avoid a return to 'fair return' thinking.

Moreover, an end must be put to the practice of deferring expenditure under the Structural Funds to future budget years, as this leads to the accumulation of resources at the end of the period covered by the *Financial Perspectives*, and hence to a compulsion to spend these resources at this time.

Recommendation 5:
The AIV recommends making the following changes to the cohesion policy:

a. *lowering the percentage contributions from the EU budget to a maximum of 25% in the case of the relatively rich member states (50% in the case of the poorer member states);*
b. *forming a large reserve (of at least 10% of the budget) that is not distributed in advance in the form of national envelopes but instead remains available to fund projects that come out best in an international competition; and*
c. *restricting the privileged status of Structural Funds (i.e. curtailing the practice of deferring excessive amounts of expenditure under the Structural Funds to the end of the period covered by the Financial Perspectives, and thus preventing the accumulation of resources and disbursement pressure).*

In the light of the poorer member states' absorption capacity, the AIV also recommends capping this type of expenditure, especially as it is intended to cofund projects supported by the EU. Taken together with the share of GNI^{EU} accounted for by the member state in question, this would lead to a ceiling of 0.35% of GNI^{EU} being placed on the Structural Funds. As a result, expenditure on Portugal and Greece would be limited to 0.10% of GNI^{EU}, while spending on the ten member states which acceded on 1 May 2004 would be limited to almost 0.19% of GNI^{EU} and a limit of 0.04% would be placed on spending on the two most recent member states, Romania and Bulgaria.

Recommendation 6:

Given the poorer member states' absorption capacity, the present limit for annual expenditure on the cohesion policy should be retained.

In order to achieve the Lisbon targets for sustainable growth, labour participation rates need to be raised in all member states. The action to which the member states have

44 André Sapir et al., *An Agenda for a Growing Europe, Making the EU Economic System Deliver*, Report of an Independent High-Level Study Group established on the initiative of the President of the European Community, July 2003.

committed themselves is defined in the employment guidelines applying to each member state. Implementation depends on the 'method of open coordination'. The AIV would warmly welcome any additional EU action to encourage the member states in this connection.

Recommendation 7:

The EU should help the member states to meet the Lisbon targets for raising labour participation rates, by cofunding their actions with money from the Structural Funds, and from the European Social Fund in particular.

The AIV also believes that, in order to raise the EU's visibility in the member states, the EU should continue to encourage small-scale, cross-border infrastructural projects. These include projects for connecting networks of cycle routes on either side of a national border, or creating joint business parks. This small fund (cofunded by the member states) should be retained, particularly as it offers an opportunity to invest in projects that would not otherwise get off the ground. This type of support not only improves links between regions on either side of a national border, but also raises the EU's public profile.

Recommendation 8:

The EU should continue to cofund small-scale, cross-border infrastructural projects that could not be carried out with commercial funding, even if the areas in question are located in relatively wealthy member states.

3. Common agricultural policy

By greatly improving the efficiency of agricultural production in recent decades, the Common Agricultural Policy (CAP) has helped to create a well-developed, robust and competitive agro-industry. The foundations were laid in the form of a policy of market and price support, under which producers were paid fixed prices for their agricultural produce that were agreed on a Community-wide basis. As already mentioned, controversy has raged since the 1980s about the proportionality of this policy, which was in danger of becoming the victim of its own success. There were three major impediments to the continuation of the traditional market and price support, i.e.:

- *a budgetary limit*: it was clear that the cost of the CAP was spiralling out of control and would result in large surpluses;
- *an ecological limit*: the more intensive use of land and natural resources sharply increased the pressure on the natural environment; and
- *an external limit*: conflicts arose with trading partners in the World Trade Organisation (WTO). The practice of dumping food surpluses in non-EU countries distorted the markets for a wide range of food products, particularly in developing countries, actually jeopardising food supplies in a large number of countries.

In 1992, the first steps were taken to move away from a system of market and price support to one based on direct income support.[45] The value of agricultural support declined markedly as a result. However, because this reform of the CAP shifted the burden from consumers to taxpayers, the lower intensity of the support provided was only reflected partially in the EU's agricultural budget.

45 This process is known as the 'MacSharry reforms'.

The 2003-2005 reforms represented a further step on the road to a more effective, market-oriented and sustainable CAP. The new policy is a twin-track policy. The first track, consisting of the regulation of agricultural markets, has led to the bulk of price support being replaced by price compensation aid in the form of a 'decoupled single farm payment' that is linked not to agricultural production, but to the observance of statutory regulations and other rules relating to the environment, nature and quality (in a system known as 'cross-compliance'). The second track consists of the wider policy on rural development, which means placing greater emphasis on the role played by farmers as stewards of the countryside, expressed in terms of certain ecological features.

With the CAP in its revised form being aimed more at achieving certain social objectives, the question is whether full or partial EU funding is still in line with the principles of subsidiarity and proportionality. The AIV takes the view that the valuation of ecological features is primarily a regional or national issue.

Recommendation 9:

> *The AIV believes that a further reform of the CAP is needed. The appropriateness and the social legitimacy of the current form of income support for farmers remain sensitive issues. The AIV believes that the CAP needs to be adapted in the near future to reflect new social needs much more closely. The policy pursued by the current Dutch government of linking EU income support for farmers more closely with the fulfilment of certain social needs such as food safety and food security, the preservation of the natural landscape, environmental protection and animal welfare (see the Coalition Agreement of February 2007) suggests that things are moving in the right direction. Further action needs to be taken in this respect.*

Cofunding by the member states could assist the gradual process of defining and clarifying the link between income support and the meeting of certain social needs.[46] For example, payment of income support could be made contingent on the performance of 'green services' in relation to landscape management. The cofunding of single farm payments within a common framework (preventing the distortion of competition on the single market) would give member states an opportunity to respond in their own way to the wide diversity of conditions and preferences in the EU. Member states would then be at liberty to create their own national variations within this common framework. This is a vital point, bearing in mind the needs of the new EU member states in Central and Southeast Europe. However, there are also big differences among the 15 'old' member states. In France, for example, there is the problem of the depopulation of rural areas, which requires a completely different response than the typically Dutch problem of a high pressure on space.

Recommendation 10:

> *The AIV recommends localising the CAP, based on cofunding within a common framework that prevents the distortion of competition on the single market.*

Some commentators in the Netherlands regard cofunding as a means of achieving an additional improvement in the country's net contribution. The AIV does not believe that this standpoint is likely to prove tenable, as a perspective based primarily on financial arguments will only increase the resistance to policy reforms.

46 See in this connection Social and Economic Council Advisory Report no. 06/05, *Cofinancing of the Common Agricultural Policy*, 2006.

Recommendation 11:

The AIV urges the Dutch government, during negotiations on the reform of the CAP, not to focus attention on the financial consequences for the Dutch net contribution, and to concentrate instead on the quality of the policy.

The gradual introduction of direct income support in the new member states in Central and Southeast Europe will sharply raise farmers' incomes in these countries. This trend will be intensified by the likely future rises in the prices of agricultural products on world markets. The Commission estimates that farmers' real incomes per unit of labour will rise by 21% throughout the EU between 2006 and 2014. The biggest rise will be recorded in Bulgaria and Romania (71.8%), followed by the ten member states which acceded in 2004, where the rise is expected to be 24.9%. Agricultural incomes in the 15 'old' member states are projected to rise by 9.9%.[47]

These discrepancies will make it harder to change the policy of income support, which is to be phased in in the new member states, during the coming period. Yet change is what is needed. Although real producer prices showed a downward trend until recently, prices are now rising again, bucked by various developments, some of which are of a structural nature. The emerging economies of China and India have triggered a sharp rise in the demand for protein-containing products in particular. Thanks to these developments on the world market, the conditions for reforming the CAP have never been as propitious as they are now, despite the fierce resistance that is likely to come from the new member states, which regard their agricultural revenue from the EU as a newly acquired aquis.

Recommendation 12:

Depending on the pace of recovery in the prices of agricultural products, a growing number of European farmers will be able to earn an adequate income directly on the market. The AIV believes that this only increases the need for a more far-reaching reform of the CAP. In other words, the conditions for carrying out the needed reform of the CAP have never been as propitious as they are now.

The AIV welcomes the fact that the Commission presented preparatory proposals to the Council and the European Parliament on 20 November 2007.[48] These include plans for simplifying and capping income support, as well as encouraging production on commercial lines, especially by cereal and dairy farmers. The Commission hopes that this will help to lift the restrictions on the output of cereal and dairy produce.

4. Citizenship, freedom, security and justice

Spending on Citizenship, and on Freedom, Security and Justice, is a minor item of expenditure, accounting for just 1.3% of the overall EU budget as set out in the *Financial Perspectives 2007-2013*. This is not to say, though, that the raft of policy measures in this category is negligible. On the contrary: the growth rate envisaged for this heading is the highest in the current *Financial Perspectives* (i.e. 163%). The AIV wishes to stress its importance, given the likelihood that high priority will continue to be given to the issues of

47 European Commission, DG Agriculture and Rural Development, *Prospects for Agricultural Markets and Income in the European Union 2007-2014*, July 2007, p. 9.

48 European Commission, *Communication from the Commission to the Council and the European Parliament, Preparing for the "Health Check" of the CAP reform*, Brussels, COM(2007) 722, 20 November 2007.

security and safety for EU citizens in the future, both within the EU and on its external borders. Part of the projected expenditure is Community expenditure (e.g. on FRONTEX)[49] and part is funded on an intergovernmental basis (e.g. on Europol and cooperation in the framework of Schengen).[50] The adoption of the *Draft Treaty amending the Treaty on European Union and the Treaty establishing the European Community* should gradually (i.e. subject to a five-year transition period) lead to more expenditure being funded from the Community budget. This has the advantage of making budgetary control considerably more transparent, and also subject to the scrutiny of the European Parliament and the European Court of Auditors. Whilst the AIV welcomes this development, it would have preferred the process of change to have been quicker.

5. The EU as a global partner

As regards expenditure under the heading of 'the EU as a Global Partner', the AIV would like to focus attention on a small, but vital item of expenditure, the Common Foreign and Security Policy (CFSP, also known as the European Security and Defence Policy). A sum of €1.7 billion (3.5% of total expenditure under this heading) has been set aside for the period from 2007 to 2013 for activities under this heading. This corresponds with 0.2% of the total budget set in these *Perspectives*. This relatively small item is due to rise sharply, from €150 million in 2007 to €340 million in 2013, representing a growth of 245%. The bulk of this budget is to be spent on the civil component of missions performed under the flag of CFSP[51] and on the EU Special Representatives, who are deployed in negotiations on war zones on the EU borders, as in Moldova and Georgia.

An instrument known as ATHENA has been created for military missions and missions with military implications.[52] The idea is to pay certain specific costs relating to these missions from a common budget. This budget is sourced from the member states, on an individual basis for each mission, in accordance with an agreed formula based on the GNI of each member state. However, the ATHENA budget only covers a small part of the cost of such missions, which means that the bulk is paid by the member states taking part in the operation. In other words, these costs are paid from national budgets, under the 'costs lie where they fall' principle.

Apart from the CFSP, this heading also covers all other aspects of the Union's external policy. At present, only a relatively small amount of resources are spent on this heading, i.e. €49 billion (5.7% of aggregate EU expenditure) in 2007-2013. Spending on this policy is set to increase by around 30% during this period, from €6.3 billion in 2007 to over €8 billion in 2013.

49 This is the European Agency for the Management of the External Borders. Other examples are the European Anti-Fraud Office (OLAF), the European Monitoring Centre for Drugs and Drug Addiction and the new European Union Fundamental Rights Agency.

50 Eurojust (the European Judicial Cooperation Unit), the European Police College (CEPOL) and the European Police Chiefs' Task Force (EPCTF) are other bodies that do not yet receive Community funding.

51 See AIV advisory report no. 59, *Employing private military companies,* December 2007.

52 *Council Decision 2004/197/CFSP of 23 February 2004 establishing a mechanism to administer the financing of the common costs of European Union operations having military or defence implications*, L 63/68, 28 February 2004.

The main items on which this budget is to be spent from 2007 to 2013 are as follows:
- development cooperation (€15.1 billion);
- European neighbourhood policy (€10.6 billion); and
- pre-accession policy (€10.2 billion).

Alongside these areas, the budget is also spent on humanitarian aid, macro-financial support, the promotion of democracy and human rights, nuclear safety and cooperation with industrialised countries. There is a Stability Instrument and the Union also has a reserve for emergency relief.

Finally, the European Development Fund (EDF) is also part of the Union's foreign policy. This fund is for development projects in the ACP countries.[53] It is not part of the EU budget, which is why it does not appear in the table in Annexe IV. The EDF is filled with direct contributions from the member states for a period of five years, the size of which is based on a formula agreed by the member states. A budget of €22.7 billion has been set aside for 2008-2013. The AIV believes there are two reasons for discussing the EDF in this report. First, the question of whether the EDF should be part of the EU's regular budget has been a topic of debate for some time now. The Dutch government has made clear on a number of occasions that this is a course of action it supports. Second, EDF resources are used to promote peace and stability in the context of the African Peace Facility. This means that the EDF helps to achieve certain objectives of the EU's CFSP. The AIV is currently preparing an advisory report on the harmonisation of Dutch and EU development policy. One of the important issues in this context is the difference between money that the OECD-DAC classifies as 'official development assistance' (ODA) and other money, which is classified as being non-ODA resources.[54] As far as the CFSP is concerned, this depends primarily on the place where the activities are performed. In other words, peacekeeping in a developing country counts as ODA, but not if performed elsewhere. Ninety per cent of the budget for 'the EU as a Global Partner' is ODA. In the light of global political developments, the AIV is in favour of raising the non-ODA component of the budget, without making any corresponding cut in ODA expenditure.

Against the background of the resources currently available for spending on policy under the heading of the 'EU as a Global Partner', the AIV wonders whether, against the background of the financial reforms and the *Financial Perspectives* for the period after 2013, this budget should not be raised and, if so, which sectors covered by this policy should receive more money. Before discussing this issue, the AIV wishes to make a number of comments on the way in which this policy is funded.

53 The ACP group of nations consists of African, Caribbean and Pacific countries that have special ties with the EU. In Africa, the group includes all sub-Saharan countries. The ACP-EU partnership used to be based solely on trade, but the scope of the partnership agreement has now been expanded to include chapters on democracy, human rights and similar issues.

54 Official Development Assistance. This is defined as: 'Grants or Loans to countries and territories on Part I of the DAC List of Aid Recipients (developing countries) which are: (a) undertaken by the official sector; (b) with promotion of economic development and welfare as the main objective; (c) on concessional financial terms [if a loan, having a Grant Element (q.v.) of at least 25%]. In addition to financial flows, Technical Co-operation (q.v.) is included in aid. Grants, Loans and credits for military purposes are excluded.' See OECD-DAC Glossary, URL: http://www.oecd.org/glossary/0,3414,en_2649_33721_1965693_1_1_1_1,00.html#1965586.

1. The AIV believes that, in setting the budget, it is important to take account not just of its size, but also of whether the money is spent effectively. Effectiveness is partly a question of the degree to which development policy is harmonised with policies pursued under other headings. Particularly in the broader field of conflict prevention, crisis management, the promotion of stability and reconstruction, joint EU action has a far greater added value than the individual actions of one or more member states. The risk inherent to the fragmentation of instruments and resources is a lack of effectiveness and efficiency, and inadequate harmonisation, cohesion and flexibility. Apart from the fact that resources from the CFSP, the EDF, the Stability Instrument and ATHENA are used for this purpose, they are also subject to different decision-making procedures (i.e. intergovernmental in some cases and Community in others) – as in the case of the previous heading. This means that decisions are disparate, in terms both of their legal basis and of their method of funding (which ranges from permanent contributions to ad-hoc grants). This is particularly problematic where member states decide to oppose EU action because they may be asked to make a financial contribution. The same lack of coherence also affects the harmonisation of spending on development cooperation and the CFSP.

2. Despite having just argued in favour of a simpler and more coherent range of financial instruments, the AIV realises that a more fundamental reform within the current treaty arrangements (including those under the *Draft Treaty amending the Treaty on European Union and the Treaty establishing the European Community*) is complicated by the wish of certain member states, for financial and political reasons, to retain the strict division between the intergovernmental CFSP on the one hand and Community external policy on the other.[55] Having said this, the AIV expects the appointment of the new-style High Representative to lead, in practical and operational terms, to greater cohesion in the use of budgetary resources for external policy.

3. The AIV believes there are enough opportunities under the present budget to raise the resources earmarked for external policy, if desired. Any rise will be relatively modest, the AIV assumes. Firstly, the budget for 'the EU as a Global Partner' should eventually create scope for allocating more resources to external policy, because less money is needed, for example for spending on areas such as the pre-accession policy. Secondly, policy changes in other fields, such as the CAP, should free up resources elsewhere in the EU budget for stepping up spending on the external policy.

4. In certain key areas, the Union's activities in the field of external policy will be supplementary to, rather than replacement for, the policies pursued by the member states. After all, the European capacity for CFSP depends primarily on the size of national defence budgets. The same is true of the policy on development cooperation, where the majority of resources stem from national budgets of the member states. This means that the EU is in a good position to promote policy cohesion and to work towards closer harmonisation with the member states and multilateral institutions. In those cases in which the EU intervenes with its own resources, such interventions must offer a tangible added value. The AIV believes that the EU can offer value in any event in relation to the CFSP, i.e. in organising joint action under the aegis of the EU in the fields

55 The AIV points out in this connection that any rise in the CFSP budget is likely to be acceptable to the European Parliament only if the latter is given more influence in this policy area. Many member states are likely to resist this, however.

of conflict prevention, crisis management and reconstruction.[56] The EU's added value lies primarily in the wide range of instruments available to it under its various pillars.

5. It is not always easy to estimate the future need for financial resources, particularly in relation to the CFSP. After all, crises and conflicts are by definition situations that cannot be planned or budgeted in advance. However, in order to enable the EU to respond to situations covered by the CFSP effectively, rapidly and with the appropriate resources, the AIV believes that a reserve or emergency fund should be formed that can be used to fund EU responses to crises.

Bearing in mind these preliminary considerations, the AIV believes that more EU budget resources should be allocated to external policy. The AIV has reached this conclusion on the basis of the following arguments.

a. The AIV believes that the member states will find themselves facing more challenges in relation to external relations and security policy in future. Whilst these challenges will be highly diverse (ranging from migration to armed conflicts), all of them will require a response in the form of joint action. However, the EU cannot play a more active part in this wide field if it does not have access to the appropriate funding.

b. The AIV assumes that the international community will make more frequent appeals to the EU in the future to play an active role in controlling and stabilising areas which are affected by a crisis or where a crisis has just been defused. Such areas will include those in which the EU has a special geographical and/or political responsibility (such as the Balkans and Moldova) and those in which the EU is the most obvious or acceptable choice in political terms (e.g. the Middle East and the African ACP countries).

c. This special responsibility also applies vis-à-vis the EU's neighbours. These relations will require extra attention during the coming years, if only because the EU will not be able to agree to requests from a number of these countries to join the Union in the near future. This is also an area in which the AIV believes that more resources will need to be deployed.[57]

d. Research shows that the general public is in favour of the EU playing a more active role in the field of external relations and in relation to issues of peace and security. From the perspective of the general public, EU action has an added value.

In the light of the above, the AIV wishes to make the following recommendations in relation to the funding of the EU's external policy:

Recommendation 13:

The EU should take advantage of the financial reforms to work towards:

a. the Community-based funding of all parts of the budget (instead of the current situation, in which certain items are funded on an intergovernmental basis);

b. the allocation of more resources to external policy; and

56 Which other fields are also high-priority areas is a matter that will be discussed in the advisory report the AIV is currently preparing on the harmonisation of Dutch and EU policy on development cooperation.

57 See in this connection AIV advisory report no. 44, *The European Union's new eastern neighbours*, July 2005.

c. *raising the non-ODA proportion of the budget (90% of the money budgeted for 'the EU as a Global Partner' in the Financial Perspectives 2007-2013 is classified as ODA), placing special emphasis on the Union's role in the fields of conflict prevention, crisis management and the promotion of stability and reconstruction, without making any corresponding cut in ODA expenditure.*

Recommendation 14:

The European Development Fund (EDF) should be brought under the regular EU budget. This will not only create synergies, but also enhance the Fund's transparency.

In implementing the above recommendation, the EU will however need to find a lasting solution to the problem of the African Peace Facility, which will probably no longer be fundable from the EDF if the latter is financed from the EU budget.

Recommendation 15:

The Union and the member states will need to make a greater effort, as part of the reforms, to ensure that their resources are used more coherently. The key considerations in this context are the added value of EU policy, effectiveness, continuity and a fair distribution of the financial burden over the member states.

6. A mechanism for correcting budgetary imbalances

As already mentioned, although the current budgetary imbalances stem primarily from the expenditure side of the budget, reforming the EU's spending policy in the manner described above will not eradicate the problem overnight. Fundamental reforms at the EU are inevitably gradual, which means that some sort of correction mechanism will still be needed for the time being.

The more spending policy moves in the direction we are proposing, the smaller the correction will become and, ultimately, the less it will be needed. A reform on the lines we are suggesting will make it easier to adopt a general correction mechanism, and abandon the current, complex and opaque mechanism in which compensations are agreed and paid on the revenue side of the budget.

Against this background, the AIV recommends the adoption of a general correction mechanism that is designed, subject to certain limits, to reduce excessive imbalances on the *expenditure side* of the budget. The existence of a general mechanism implies that *all* member states would be required to cofund compensation payments. In the present system, the UK does not fund any of its own rebate, and four member states, i.e. Germany, the Netherlands, Austria and Sweden, are required to make only partial payments. This 'rebate after rebate' is effected by setting a lower call rate for VAT payments (one third lower in the case of the Netherlands and Sweden). In addition, the Netherlands and Sweden also receive a lump-sum rebate on their GNI payments of €605 million per annum. The result is a completely opaque system. It is also very hard to explain why the poorer countries, such as the new member states, should contribute relatively large amounts of money to a rebate scheme from which the richer countries benefit.

A general correction mechanism involving the payment of compensation on the expenditure side, which would mean it would be funded by all member states, would not only be simpler and easier to understand, it would also be fairer in its operation. As we have already pointed out, the Commission's 2004 proposals formed a useful first step

towards a general correction mechanism.[58] These proposals were based on two important principles, i.e. that only *excessive* imbalances should be corrected, and that correction should be *subject to limits*.

Under the Commission's proposals, the correction mechanism would take effect only once a member state's net contribution crossed a preset threshold value. The figure quoted as a possible threshold value was 0.35% of GNI. Up to 66% of the excess would be eligible for compensation (as is the case with the current British rebate), up to a given *ceiling*. The method used for calculating the net contributions would be the current, tried and tested system. The Commission proposed a compensation ceiling of €7.5 billion per annum. If the threshold value were set at 0.35% of GNI, this would mean an average annual gross correction of some €7 billion during the period covered by the current *Financial Perspectives*. Obviously, the net correction would be lower, as the mechanism would be cofunded by all the member states.

The table below shows the result of the system proposed by the Commission, expressed in net contributions as a percentage of GNI.

While this would lead to the UK losing a large amount of revenue, the damage could be limited by gradually phasing in the new system. Moreover, the UK receives too much compensation under the present system. Although the other net contributors, including the Netherlands, would also lose out, the overall cost of the correction mechanism would be lower than that of the current system, and the cost would gradually decline in the future.

The AIV does not wish to make any pronouncements about the precise figures that should be set for the threshold value and the ceiling, as these are matters for negotiation. Moreover, it would be logical for the new system to be phased in gradually. The AIV does believe, however, that a correction mechanism designed along these lines would be a viable option.

Assuming that cuts are indeed made in the EU's expenditure, there should be a gradual decline in the maximum amount for which compensation needs to be paid. If the EU adopts a spending policy that hinges on the added value of joint EU action, and assuming that the principles of expediency, subsidiarity and proportionality are strictly observed, there should eventually be no need at all for a correction mechanism.

Recommendation 16:

> *The AIV recommends the adoption of a general correction mechanism designed to provide compensation for excessive imbalances on the expenditure side of the budget, subject to certain limits. This mechanism would replace the complex system of corrections on the revenue side of the budget.*

58 European Commission, *Proposal for a Council Decision on the systems of the European Communities' own resources and Proposal for a Council Regulation on the implementing measures for the correction of budgetary imbalances in accordance with Articles 4 and 5 of the Council Decision of (...) on the system of the European Communities' own resources*, Brussels, 14 July 2004, COM(2004) 501. See also European Commission, Report of the Commission Volume I, *Financing the European Union, Commission report on the operation of the own resources system*, COM(2004) 505 final/2, Brussels, 6 September 2004 (Schreyer proposals), and Volume II, Technical Annex, *Financing the European Union, Commission report on the operation of the own resources system*, COM(2004) 505 final, Brussels, 14 July 2004.

Recommendation 17:

The AIV believes that such a correction mechanism could be phased in, with effect from 2014. Assuming that cuts are made in the EU's expenditure, the maximum value of compensation should gradually decline.

Estimated net contributions as a percentage of GNI, based on the Commission's 2004 proposals, with a threshold value of 0.35% and a ceiling of €7.5 billion.

AVERAGE	% 2008 – 2013
Luxembourg*	5.85
Latvia	4.45
Lithuania	4.44
Poland	3.80
Estonia	3.79
Slovakia	3.31
Czech Republic	3.21
Hungary	3.09
Greece	2.20
Portugal	1.54
Slovenia	1.34
Belgium*	1.27
Malta	1.10
Ireland	0.51
Spain	0.26
Finland	-0.19
Denmark	-0.25
Cyprus	-0.33
France	-0.33
Italy	-0.35
Austria	-0.41
Sweden	-0.45
Germany	-0.48
The Netherlands	-0.48
UK	-0.51

* Belgium and Luxembourg are both net contributors if expenditure on Administration is discounted.

Source: European Commission, Volume II, Technical Annex, *Financing the European Union, Commission report on the operation of the own resources system,* COM(2004) 505 final, Brussels, 14 July 2004, Table XIII, p. 73.

IV EU revenue

As stated in the Introduction to this report, the EU's system of revenue has grown into a complex patchwork of corrections and exceptions over the years. Nevertheless, it offers sufficient guarantees that the Union's revenue will cover its expenditure. In this sense, the current system is both robust and stable. Under the current system, the EU derives its revenue from three sources:

1. the EU's *traditional own resources*, i.e. agricultural levies and income from customs duties (which are charged on goods as they enter the EU);
2. a proportion of *value-added tax (VAT)* revenue; and
3. payments based on the *gross national income (GNI)* of each member state.

In addition to these three components, there is also a small residual category for income such as fines, plus rebates on the above sources of income for certain countries, which are funded by the other member states.[59]

The agricultural levies were introduced in 1962, with the customs duties following in 1968. Since 1970, the income raised from both these sources has been passed on to the European Community (EC). In 1974, it was decided to stop distinguishing between these two sources. In 1988, the traditional own resources of the European Coal and Steel Community (ECSC) were transferred to the EC. Since 2000, the member states have withheld 25% of the value of the levies to cover collection costs.

Although VAT was introduced on 21 April 1970, it was not until 1980 that it became a source of EU revenue. It is by definition a highly regressive tax, given that poor households (and hence poor countries) spend a relatively larger proportion of their income on buying products. For this reason, a correction is required: from 1988 to 1994, VAT payments were subject to a ceiling of 55% of the gross national product (GNP). In 1995, this ceiling was reset at 50% of GNP for those countries whose GNP was less than 90% of the EC average. Since 1999, the 50% ceiling has applied to all member states. In addition, it was decided in 1970 that the appropriation should be capped at 1.0% of VAT revenue. This figure was raised to 1.4% in 1985. From 1995 to 1999, it was set at 1.0%, and subsequently reduced to 0.5% in 2000.

The GNI component was introduced on 24 June 1988. This also put an end to the debate among the member states on the different ways of computing GNP. The GNI component is a balancing item that makes up the difference between the EU's revenue and expenditure, and is subject to a ceiling of 1.4% of aggregate GNI in the EU. In the *Financial Perspectives 2007-2013*, this ceiling was set as 1.24% of GNI^{EU}.

The amount of income the EU earns from its various sources of revenue has radically changed in the course of time. For example, there has been a sharp decrease in the income generated by the EU's own resources and by VAT payments; today, the GNI component is by far the largest source of EU revenue. Following the expansion of the number of countries benefiting from a preferential trading regime,[60] and in the wake of successive WTO rounds, the EU has now lifted, step by step, the tariff barriers consisting of agricultural levies and

59 See in this connection the final section of the previous chapter.

60 When the EU was first formed, a special partnership was forged with a number of African, Caribbean and Pacific countries, known as the ACP countries. This group has gradually grown in number, and now stands at 78 (2007).

import duties for the majority of goods (as indeed have other countries). The value of the EU's traditional own resources will decline further in the future, particularly now that the Doha Round has been successfully completed.

The income from the traditional own resources component accounted for some 14% of the EU's aggregate revenue in 2006, whilst VAT payments accounted for around 16% and GNI payments for approximately 65%. Total income from the EU's own resources amounted to almost €102.4 billion in 2006, or 0.90% of GNI^{EU}. This was supplemented by additional income worth ?6.1 billion. Aggregate expenditure stood at €107.4 billion in 2006 in payments, or 0.94% of GNI^{EU}.[61]

As discussed in the previous chapter, the system is far from simple. This is due mainly to the great diversity of corrections and rebates, all of which vary from one country to another. Against this background, the AIV once again endorses the Commission's 2004 proposal to introduce a general rebate. Partly because of the present situation, the deliberations on the EU's *Financial Perspectives* have become increasingly fraught.[62] It is not simply a matter of undoing the undesirable effects of accumulated rebates and corrections on the quality of the EU's spending policy. The AIV also regards the adoption of a general rebate as vital for ensuring that the EU's system of own resources is both simple and fair. It is quite right that, when the Council decided in December 2005 to launch a general reform of the EU's finances, the decision affected the system of own resources as well as the EU's expenditure policy.[63]

Criteria for a system of own resources for the EU

One of the basic criteria that needs to be met by a new system of own resources is that it should respect the EU's autonomy. This means that the member states' contributions should be compulsory and should not, as in the case of the contributions made to UN organisations, for example, vary from one year to another depending on the budget negotiations in each member state. A further criterion adopted in this report is that any alterations made to the EU's financial foundations:

(i) should enable the EU's own resources to remain under the present ceiling of 1.24% of GNI^{EU}; and

(ii) should not lead to a substantial rise in expenditure above the level of 1% of GNI^{EU}.

Several publications have already appeared setting out the conditions that a system of own resources needs to satisfy.[64] The result is a plethora of such criteria. The AIV believes that the main ones are:

61 European Commission, DG Budget, *EU budget 2006 Financial Report*, 2007, pp. 7, 8, 29 and 30.

62 AIV advisory report no. 52, *Europe: a priority!*, November 2006, pp. 9 and 10.

63 *Conclusions of the European Council*, 15-16 December 2005, 15914/05. See Conclusion 6 and Presidency of the European Council, *Financial Perspectives 2007-2013*, Brussels, 19 December 2005, CADREFIN 268, document no. 15915/05. See Part III, Review.

64 See also in this connection: Jacques Le Cacheux, Funding the EU Budget with a Genuine Own Resource, The Case for a European Tax, *Notre Europe studies*, 57, May 2007; Philippe Cattoir, Tax-based EU own resources: An assessment, *Taxation Papers*, DG Taxation & Customs Union, Working Paper No 1/2004. See also the report by Alain Lamassoure, Report on the future of the European Union's own resources (2006/2205(INI)), European Parliament, *Working document*, 13 March 2007, final version A6-0066/2007.

1. *adequacy*: the system should generate enough money in aggregate to cover the EU's spending needs;
2. *stability*: the income generated by the system should offer sufficient security;
3. *efficiency*: the collection costs should be as low as possible; and
4. *equity*: member states should contribute on a *pro rata* basis, in accordance with their national incomes.

As far as the final criterion is concerned, it is also important to take account of the system's equity vis-à-vis citizens, i.e. citizens should also contribute on a *pro rata* basis, in accordance with their incomes ('vertical equity') and citizens from the same social group should pay the same amount ('horizontal equity'). The system should also be as simple as possible, so that ordinary citizens find it easy to understand.

A fifth criterion, *visibility*, should really be added to the list. However, given the current state of the economy, this criterion is unlikely to make much of an impression on the general public: there would appear to be little public support at present for a new EU tax. For this reason, the AIV decided not to include this criterion on its list of important criteria.

Alain Lamassoure's report to the European Parliament contains a number of appendices with recommendations from the Committee on Budgetary Control, the Committee on Economic and Monetary Affairs, the Committee on Regional Development and the Committee on Constitutional Affairs, among other bodies.[65] These committees favour the adoption of a number of more technical criteria.[66] Whilst it would be beyond the scope of this report to subject all of these to a detailed examination, the AIV does recognise their value.

Options

The Commission has subjected various alternative systems of own resources to closer scrutiny.[67] Its 2004 communication assumes there are three options for the EU to raise its own tax resources:
1. own resources related to energy consumption (excise duties);
2. own resources related to VAT; and
3. own resources related to corporate income.

Cattoir's 2004 assessment of the DG Taxation and Customs Union[68] and Lamassoure's report to the European Parliament published in March 2007[69] are of particular interest in

65 Alain Lamassoure, Report on the future of the European Union's own resources (2006/2205(INI)), European Parliament, *Working document*, 13 March 2007, final version A6-0066/2007.

66 These are transparency, democratic controllability (by the European Parliament and the European Court of Auditors), resistance to fraud and resistance to corruption.

67 European Commission, Report of the Commission Volume I, *Financing the European Union, Commission report on the operation of the own resources system*, COM(2004) 505 final/2, Brussels, 6 September 2004 (Schreyer proposals), and Volume II, Technical Annex, *Financing the European Union, Commission report on the operation of the own resources system*, COM(2004) 505 final, Brussels, 14 July 2004.

68 Philippe Cattoir, Tax-based EU own resources: An assessment, *Taxation Papers*, DG Taxation & Customs Union, Working Paper No 1/2004.

69 Alain Lamassoure, Report on the future of the European Union's own resources (2006/2205(INI)), European Parliament, *Working document*, 13 March 2007, final version A6-0066/2007.

this respect. The AIV has deliberately chosen not to examine the wide range of alternative options (such as income tax, wealth tax, seignorage, communication tax, flat-rate income tax, the taxation of financial transactions or air travel, and excise duties on alcohol and tobacco), as experts regard these as being either impractical or not capable of meeting the criteria set.[70]

The AIV wishes to state emphatically that none of the tax-based own resources discussed in this report are intended to be levied or collected by the EU. Both the Commission and the European Parliament have emphasised the tax-raising sovereignty of the member states. Accordingly, the three options proposed by the Commission may not be regarded as new EU taxes. Rather, they merely involve the *allocation* to the EU of part of the income earned from national taxes.

The AIV also wishes to point out that, whatever system of tax-based own resources is adopted, there will always be a need for residual funding. Unlike the member states, the EU is not entitled to raise loans, which implies that its revenue and expenditure must be in equilibrium. This means in turn that a small adjustment may need to be made each year in order to balance the books. This is an extra complication in any new system of own resources.

We shall now examine the three options put forward by the Commission, in the light of the criteria set out above.

1. Own resources related to VAT

In 1994, the European Parliament already gave its backing to the principle of a system of own resources linked to VAT.[71] Unlike under the current, 'statistical' system of VAT payments, the idea was that this would be a genuine tax-based VAT source of income, in which a percentage of national VAT revenue would be collected on behalf of and allocated to the EU.

A VAT-based own resource scores relatively well in relation to the criteria set. It scores well in terms of *adequacy*: based on the current basis of assessment, 1% of VAT would be sufficient to fund half the EU's current budget. It is also a *stable* source of income. As far as *efficiency* is concerned, despite being seemingly easy to adopt at a national level, it would involve a huge amount of time-consuming paperwork. Moreover, a number of crucial problems would first have to be resolved at EU level. There is the question of the full harmonisation of VAT rates: certain goods and services are still zero-rated in certain countries, and there are all sorts of different exceptions and tax deductions in operation. Although these problems can be eliminated by adopting compensation schemes and agreeing on the further harmonisation of tax rates, the talks on these issues would be far from straightforward. All things considered, the Commission believes that six years would be required in order to introduce a VAT-based own resource in the EU.

70 See, in addition to Cattoir's and Lamassoure's analyses, Jacques Le Cacheux, Funding the EU Budget with a Genuine Own Resource, The Case for a European Tax, *Notre Europe Studies*, 57, May 2007, and J.F.H. Inghelram, Welke toekomst voor de financiering van de EU? ('What future for EU funding?'), *SEW*, no. 5, May 2007, pp. 191-200.

71 Langes, H., Report for the Committee of Budgets on the System of Own Resources in the European Union, *European Parliament Working Documents*, A3-228/94, 1994.

As far as *horizontal equity* is concerned, there is not only the problem of the difference in tax rates caused by the use of zero-rating, but also the fact that the basis of assessment is higher in relatively poor countries when expressed as a percentage of national income, than in relatively rich countries (which is why VAT may be described as a regressive tax). It was precisely for this reason that it was decided to lower the maximum percentage of VAT payments in the current system. Moreover, in the poor countries themselves, the poor pay relatively more VAT than the better-off, because they spend more in relative terms on essentials and save less. In other words, this is not good news for *vertical equity*. In his 1994 report, Langes tried to compensate for this effect by proposing a balanced system of VAT payments, based on the principle of a high percentage being charged for high-rated goods and services and a low percentage for low-rated goods and services (such as essentials).

As regards the criterion of public *visibility*, as we have already mentioned, this is not an important issue given the current state of the economy and for this reason we do not wish to attach a great deal of value to it. This is because the public are bound to regard a new system of own resources as constituting a new EU tax, and this is not something that is likely to prove very popular at present.

2. Own resources related to energy consumption (excise duties)

A basic condition for the adoption of a system of tax-based own resources is the existence of a harmonised basis of assessment throughout the EU. As far as excise duties on fuels such as diesel, petrol and LPG (known collectively as ‘motor fuels’) are concerned, the basis of assessment has indeed been harmonised, in the form of minimum taxation rates set by a Council Directive.

This particular resource scores well in terms of *adequacy*. Under the Commission’s 2004 proposal, half of the revenue generated from excise duties on motor fuels (based on the current minimum rates) would be enough to fund half the EU budget. As this is a tax on consumption and the price-elasticity of demand is low, the revenue generated should be fairly *stable*. As regards *horizontal equity*, the problem is that there are large differences between the member states in terms of their shares of aggregate fuel consumption in the EU and their shares of GNI^{EU}. As a result, this particular resource scores low on this count.

More generally, the AIV believes that there is less public support in the EU for levying energy taxes with the sole purpose of raising money for public funds. It would be a completely different matter if the EU imposed energy taxes in order to discourage motorists from using their cars, with the aim of reducing environmental pollution. In fact, the EU Treaty contains various provisions on this type of energy tax (article 175 of the EU Treaty), for which there would be much broader public support in the EU. Going into this point in further detail would, however, be well beyond the scope of this report.[72]

3. Own resources related to corporate income

The lack of a harmonised basis of assessment means there is very little chance of this type of own resource being adopted. Previous attempts to harmonise the bases of corporation tax assessment in the various member states consistently encountered fierce resistance in

72 See also General Energy Council and AIV advisory report no. 46, *Energised Foreign Policy: security of energy supply as a new key objective*, December 2005 and AIV advisory report no. 52, *Europe a priority!*, November 2006.

the European Council of Ministers. As a further drawback, the cyclical nature of corporate profits means that it is not possible to guarantee the *stability* of revenue from this source. The AIV believes that this resource is the least viable of the three, in either the short or the long term.

Conclusions

On the basis of a technical assessment of the various options, the AIV concludes that there is no chance of agreement being reached on a totally new system of own resources in the medium term. None of the options under review fully complies with all the criteria. Moreover, the current system of GNI-based budgetary payments is adequate in every respect, easy to use and by definition equitable. In the long term, the AIV believes that a VAT-based own resource offers the best prospects.

From a political viewpoint, too, a fundamental reform of the own resources system would not appear to be practicable in the medium term. With the process of ratification of the *Draft Treaty amending the Treaty on European Union and the Treaty establishing the European Community* now in full swing, and European elections and the appointment of a new Commission just around the corner, there is unlikely to be any interest whatsoever in such a reform. The consultation paper recently published by the Commission also does little to suggest that an ambitious reform of the own resources system is on the cards. In this connection, the AIV equates the 'medium term' with the period of the next *Financial Perspectives*, i.e. after 2013 or possibly even after 2020.

The AIV does believe, though, that the current system of own resources urgently needs to be rid of the current, complex correction mechanism. As proposed in the previous chapter, this should be replaced by a general mechanism operating on the expenditure side of the budget. Scrapping the correction mechanism would make the current own resources system much simpler, more equitable and more transparent.

The AIV believes that the budgetary imbalances can be ironed out in the medium term by reviewing spending policy and adopting a more limited, general correction mechanism.

Despite the above conclusions, it would nevertheless be preferable in the long term for the EU's revenue to be sourced by definition from outside the national budgets, as the AIV also indicated in a previous report.[73] This is because the current system entails a risk of EU policy being overshadowed by the debate on net contributions that has dominated the past few decades.

Recommendation 18:

> *The AIV believes that it would not be feasible for the EU to adopt a completely new system of own resources in the short or medium term.*

Recommendation 19:

> *The AIV continues to believe that the door should remain open in the long term to a system of own resources that is not based by definition on a system of national budget allocations.*

Recommendation 20:

> *In the long term, the AIV believes that, of the various options, a VAT-funded own resource, as proposed by the Commission, is the most appropriate way of funding the EU.*

73 AIV advisory report no. 52, *Europe: a priority!*, November 2006: see Chapter II.

V Conclusions and recommendations

The AIV hopes that this advisory report, and the recommendations contained in it, will foster debate prior to the adoption by the Dutch government of a standpoint on the EU's finances.

The AIV has deliberately chosen to focus on the medium term and on reforms that are politically realistic and practicable, against the background of the comprehensive, wide-ranging review the European Council has called for in 2008-2009. The AIV has taken account of the fact that this is not the right time for more fundamental reforms, especially as these would coincide with the ratification of the *Draft Treaty amending the Treaty on European Union and the Treaty establishing the European Community*.

A special rebate was agreed for the UK over 20 years ago, and this remains in force today. Now that the UK's prosperity has greatly increased and a number of relatively poor member states have joined the Union, there can be no doubt that this rebate is excessive. Moreover, the scheme does not contain a sunset clause (i.e. in theory, it lasts forever) and the UK is entitled to veto any attempt to alter it. The adoption of a general correction mechanism in which the British rebate would be subsumed is, in fact, the only means of ending the special correction arrangement made for the UK.

The AIV believes there is a need to get away from the debate on net contributions and to assess policy – spending policy in particular – in terms of its added value for the EU as a whole.

Two key points in this respect are the reorientation of the EU's spending policy and the overhaul of the correction mechanism. The AIV believes that these are inextricably linked. There is no chance of the British rebate being scrapped without expenditure on the CAP being lowered. Equally, it is not realistic to conceive of a fundamental reform of the CAP without addressing the issue of the British rebate.

The AIV believes that the time is now right for ending this vicious circle by focusing on the quality of policy during the forthcoming negotiations, with the aid of objective assessment criteria. During the past two decades, EU policy has been seen far too much in terms of amounts and percentages.

A limited, general correction mechanism will still be needed for some time to come. It will tend to decline in size and to become less necessary, however, as spending cuts take effect and the principles of expediency, subsidiarity and proportionality become the overriding factors.

For both technical and political reasons, the AIV concludes that there is no chance of agreement being reached in the medium term on a more fundamental reform of the system of own resources leading to the adoption of a tax-based system of own resources. In the long term, the AIV believes that the door should not be closed to a system of own resources that is not based by definition on a system of national budget allocations. The AIV believes that a VAT-funded own resource offers the best prospects as a future means of financing the EU.

Against this background, the AIV has formulated the recommendations made in this report on the EU's expenditure and revenue.

Recommendations on the EU's expenditure
(i) in relation to the policy on sustainable growth:

Recommendation 1:

In the light of the subsidiarity principle, the AIV urges the EU to formulate a common position on the main transport routes and nodes. This is the only way of identifying possible infrastructural problems in good time and taking full advantage of the emergence of new, innovative networks. Where substantial cross-border effects can be produced, the AIV believes that the EU should encourage these by means of cofunding, in accordance with the proportionality principle.

Recommendation 2:

The single market needs to be supplemented with a European research area. This requires more money to be spent on knowledge and innovation. The AIV agrees with the recommendations made by the Sapir study group, which urged the EU to play a more active role in promoting R&D, and endorses its conclusion that far more EU budget resources need to be spent on this than the current figure of 0.05% of GNI^{EU} per annum. A redistribution of budget resources is required.

Recommendation 3:

In accordance with the principles of subsidiarity and proportionality, the AIV believes that the EU should foster R&D by cofunding large-scale programmes that would otherwise be unaffordable. The budget allocated for this purpose should not be distributed in advance in the form of national envelopes, but should instead be spent on projects that come out on top in international competitions.

(ii) in relation to cohesion policy:

Recommendation 4:

The AIV recommends concentrating convergence support on relatively poor member states (i.e. those member states whose per capita GNI is less than 90% of the EU average).

Recommendation 5:

The AIV recommends making the following changes to the cohesion policy:

a. lowering the percentage contributions from the EU budget to a maximum of 25% in the case of the relatively rich member states (50% in the case of the poorer member states);
b. forming a large reserve (of at least 10% of the budget) that is not distributed in advance in the form of national envelopes but instead remains available to fund projects that come out best in an international competition; and
c. restricting the privileged status of Structural Funds (i.e. curtailing the practice of deferring excessive amounts of expenditure under the Structural Funds to the end of the period covered by the Financial Perspectives, and thus preventing the accumulation of resources and disbursement pressure).

Recommendation 6:

Given the poorer member states' absorption capacity, the present limit for annual expenditure on the cohesion policy (3.8% of the recipient countries' GNP) should be retained.

Recommendation 7:

The EU should help the member states to meet the Lisbon targets for raising labour participation rates, by cofunding their actions with money from the Structural Funds, and from the European Social Fund in particular.

Recommendation 8:

The EU should continue to cofund small-scale, cross-border infrastructural projects that could not be carried out with commercial funding, even if the areas in question are located in relatively wealthy member states.

(iii) in relation to the CAP:

Recommendation 9:

The AIV believes that a further reform of the CAP is needed. The appropriateness and the social legitimacy of the current form of income support for farmers remain sensitive issues. The AIV believes that the CAP needs to be adapted in the near future to reflect new social needs much more closely. The policy pursued by the current Dutch government of linking EU income support for farmers more closely with the fulfilment of certain social needs such as food safety and food security, the preservation of the natural landscape, environmental protection and animal welfare (see the Coalition Agreement of February 2007) suggests that things are moving in the right direction. Further action needs to be taken in this respect.

Recommendation 10:

The AIV recommends localising the CAP, based on cofunding within a common framework that prevents the distortion of competition on the single market.

Recommendation 11:

The AIV urges the Dutch government, during negotiations on the reform of the CAP, not to focus attention on the financial consequences for the Dutch net contribution, and to concentrate instead on the quality of the policy.

Recommendation 12:

Depending on the pace of recovery in the prices of agricultural products, a growing number of European farmers will be able to earn an adequate income directly on the market. The AIV believes that this only increases the need for a more far-reaching reform of the CAP. In other words, the conditions for carrying out the needed reform of the CAP have never been as propitious as they are now.

(iv) in relation to the policy on ‘the EU as a global partner’:

Recommendation 13:

The EU should take advantage of the financial reforms to work towards:

a. the Community-based funding of all parts of the budget (instead of the current situation, in which certain items are funded on an intergovernmental basis);

b. the allocation of more resources to external policy; and

c. raising the non-ODA proportion of the budget (90% of the money budgeted for ‘the EU as a global partner’ in the Financial Perspectives 2007-2013 is classified as ODA), placing special emphasis on the Union’s role in the fields of conflict prevention, crisis management and the promotion of stability and reconstruction, without making any corresponding cut in ODA expenditure.

Recommendation 14:

The European Development Fund (EDF) should be brought under the regular EU budget. This will not only create synergies, but also enhance the Fund’s transparency.

Recommendation 15:

The Union and the member states will need to make a greater effort, as part of the reforms, to ensure that their resources are used more coherently. The key considerations in this context are the added value of EU policy, effectiveness, continuity and a fair distribution of the financial burden over the member states.

(v) in relation to the budgetary imbalances:

Recommendation 16:

The AIV recommends the adoption of a general correction mechanism designed to provide compensation for excessive imbalances on the expenditure side of the budget, subject to certain limits. This mechanism would replace the complex system of corrections on the revenue side of the budget.

Recommendation 17:

The AIV believes that such a correction mechanism could be phased in, with effect from 2014. Assuming that cuts are made in the EU's expenditure, the maximum value of compensation should gradually decline.

Recommendation 18:

The AIV believes that it would not be feasible for the EU to adopt a completely new system of own resources in the short or medium term.

Recommendations on the EU's revenue:

Recommendation 19:

The AIV continues to believe that the door should remain open in the long term to a system of own resources that is not based by definition on a system of national budget allocations.

Recommendation 20:

In the long term, the AIV believes that, of the various options, a VAT-funded own resource, as proposed by the Commission, is the most appropriate way of funding the EU.

List of persons consulted

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Dr H.A.C.M. Notenboom	Former member of the House of Representatives, former member of the European Parliament; Emeritus Professor at Eindhoven University of Technology
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List of abbreviations

ACP	African, Caribbean and Pacific (group of countries with special ties with the EU)
AIV	Advisory Council on International Affairs
CAP	Common Agricultural Policy
CFSP	Common Foreign and Security Policy
EC	European Community
ECSC	European Coal and Steel Community
EDF	European Development Fund
EMU	Economic and Monetary Union
EU	European Union
GNI	Gross National Income
GNP	Gross National Product
ODA	Official Development Assistance
R&D	Research and development
UK	United Kingdom
VAT	Value-added tax
WTO	World Trade Organisation

Annexe III

EU expenditure in each member state in 2006, taken from the *EU budget Financial Report 2007*

Source: European Commission, DG Budget, *EU budget 2006 Financial Report*, 2007, p. 61.

2006	1. Agriculture	2. Structural actions	3. Internal policies	4. External actions	5. Administration	6. Reserves	7. Pre-accession strategy	8. Compensation	Total expenditure	Traditional own resources (TOR)	Agricultural duties	Sugar levies	Customs duties	Amounts (25 %) retained as TOR collection costs	VAT-based own resource	GNI-based own resource	UK correction	JHA adjustment for DK, IE & UK	Total revenue
BE	956.1	310.4	784.4	0.0	3 574.2	0.0	0.0	0.0	**5 625.1**	1 520.9	19.3	12.4	1 996.2	−507.0	453.4	1 932.6	249.2	0.0	**4 156.1**
CZ	498.3	463.6	55.9	0.0	15.2	0.0	95.2	201.9	**1 330.0**	149.0	7.0	3.7	187.9	−49.7	173.7	632.5	80.1	0.0	**1 035.3**
DK	1 164.8	124.9	163.8	0.0	48.3	0.0	0.0	0.0	**1 501.9**	323.3	42.9	5.8	382.4	−107.8	301.6	1 399.5	168.7	−0.2	**2 193.0**
DE	6 566.9	4 388.3	1 130.6	0.0	156.6	0.0	0.0	0.0	**12 242.4**	2 927.9	232.2	48.0	3 623.6	−976.0	3 296.4	13 896.2	380.5	0.3	**20 501.2**
EE	75.6	142.5	50.5	0.0	7.3	0.0	20.8	3.3	**300.0**	19.3	0.9	0.0	24.8	−6.4	21.5	80.3	9.2	0.0	**130.3**
EL	3 071.2	3 590.5	148.0	0.0	24.0	0.0	0.0	0.0	**6 833.7**	204.4	11.5	3.1	258.0	−68.1	317.9	1 162.8	149.0	0.0	**1 834.1**
ES	6 681.4	5 767.0	375.3	0.0	59.4	0.0	0.0	0.0	**12 883.0**	1 197.9	61.6	7.9	1 527.7	−399.3	1 668.7	6 127.7	805.3	0.1	**9 799.7**
FR	10 091.7	2 235.4	745.5	0.0	423.6	0.0	0.0	0.0	**13 496.2**	1 282.6	132.1	47.0	1 531.1	−427.5	2 906.8	11 026.2	1 420.1	0.2	**16 635.9**
IE	1 736.4	475.5	209.4	0.0	40.5	0.0	0.0	0.0	**2 461.8**	202.3	0.8	1.9	267.0	−67.4	245.1	914.1	120.7	−0.1	**1 482.0**
IT	5 486.0	4 531.0	753.5	0.0	151.8	0.0	0.0	0.0	**10 922.3**	1 573.3	182.0	18.3	1 897.4	−524.4	1 679.8	9 247.2	1 006.3	0.2	**13 506.8**
CY	51.4	14.7	22.3	3.9	10.7	0.0	2.4	134.1	**239.6**	32.6	4.5	0.0	39.0	−10.9	23.6	86.5	10.7	0.0	**153.3**
LV	136.6	140.6	61.5	0.0	8.1	0.0	51.9	3.9	**402.6**	22.5	1.3	0.4	28.2	−7.5	25.3	95.7	11.6	0.0	**155.1**
LT	308.8	191.8	227.5	0.0	9.3	0.0	55.2	7.2	**799.8**	38.0	2.7	0.6	47.4	−12.7	29.3	145.1	21.4	0.0	**233.8**
LU	46.3	20.8	110.5	0.0	1 017.2	0.0	0.0	0.0	**1 194.8**	18.9	0.8	0.0	24.5	−6.3	36.9	142.5	18.9	0.0	**217.2**
HU	840.9	691.2	128.1	0.0	16.4	0.0	133.5	31.9	**1 842.2**	104.2	5.1	3.1	130.8	−34.7	115.7	501.3	61.3	0.0	**782.5**
MT	9.4	16.3	10.4	3.3	14.8	0.0	0.0	102.9	**157.0**	10.8	1.5	0.0	13.0	−3.6	7.7	28.3	3.4	0.0	**50.2**
NL	1 220.1	463.9	429.4	0.0	77.0	0.0	0.0	0.0	**2 190.4**	1 644.4	313.1	11.8	1 867.6	−548.1	887.1	3 497.1	102.8	0.1	**6 131.5**
AT	1 274.9	304.5	229.1	0.0	21.7	0.0	0.0	0.0	**1 830.1**	195.3	4.6	4.9	250.9	−65.1	385.4	1 557.1	71.4	0.0	**2 209.2**
PL	2 141.6	1 950.8	275.0	0.0	29.8	0.0	394.0	514.3	**5 305.6**	272.0	49.1	13.8	299.8	−90.7	414.9	1 563.4	196.2	0.0	**2 446.6**
PT	951.3	2 533.9	127.2	0.0	22.3	0.0	0.0	0.0	**3 634.8**	117.8	29.3	0.7	127.0	−39.3	226.4	909.4	124.8	0.0	**1 378.4**
SI	159.9	91.0	78.5	0.0	7.8	0.0	7.9	61.0	**406.0**	35.3	0.3	0.5	46.2	−11.8	47.8	174.6	21.4	0.0	**279.1**
SK	277.5	268.0	60.5	0.0	10.0	0.0	67.3	13.0	**696.2**	55.0	1.5	2.1	69.8	−18.3	58.6	254.8	33.1	0.0	**401.6**
FI	818.2	316.7	121.9	0.0	23.6	0.0	0.0	0.0	**1 280.4**	130.3	7.8	1.4	164.5	−43.4	246.8	1 071.2	111.7	0.0	**1 559.9**
SE	924.6	308.3	317.9	0.0	22.7	0.0	0.0	0.0	**1 573.4**	399.9	20.8	3.6	508.9	−133.3	456.9	1 812.7	28.1	0.0	**2 697.7**
UK	4 307.8	3 021.4	829.3	0.0	135.6	0.0	0.0	0.0	**8 294.2**	2 550.5	589.9	11.2	2 799.6	−850.2	3 178.8	11 873.5	−5 221.4	−0.8	**12 380.6**
EU-25	49 797.7	32 363.0	7 445.8	7.2	5 928.0	0.0	828.1	1 073.5	**97 443.4**	15 028.3	1 722.4	202.1	18 113.1	−5 009.4	17 206.2	70 132.1	−15.3	−0.0	**102 351.2**
Non-EU	0.9	1.6	371.3	4 217.3	137.7	0.0	1 351.8	0.0	**6 080.6**									Surplus from previous year	2 410.1
Non-allocated	0.1	15.8	719.3	819.9	505.6	127.6	63.0	0.0	**2 251.3**									Surplus from EAGGF Guarantee	0.0
Earmarked	0.0	18.9	477.3	141.8	128.5	0.0	33.8	0.0	**800.2**									Surplus external aid guarantee fund	92.7
																		Other revenue	3 569.0
Total	49 798.8	32 399.3	9 013.7	5 186.2	6 699.7	127.6	2 276.7	1 073.5	**106 575.5**									**Total**	**108 423.0**

p. m. amount of UK correction 2005 (prov.): 4 838.9

Annexe IV

Statement of EU expenditure, taken from the *Financial Perspectives 2007-2013*, as adopted on 4 April 2007

Source: Distributed in the European Parliament. See the website of the network of Technical Attachés of the Ministry of Economic Affairs): http://www.twanetwerk.nl/.
See *Nest-nieuws*, no. 69 of June 2006, p. 19.

FINANCIAL FRAMEWORK* 2007-2013

Indicative breakdown of expenditure with adjusted financial envelopes after Trialogue of 4 April 2006

(2004 prices)	2006 (c)	2007	2008	2009	2010	2011	2012	2013	2007-2013 TOTAL	Change 2013/ 2006
SUB-HEADING 1A Competitiveness for growth and employment										
TEN (transport and energy)	548	804	898	952	963	1.100	1.177	1.309	7.203	139%
Marco Polo II	34	53	55	56	57	58	60	61	400	81%
Spatial infrastructure 'Galileo'	148	94	140	182	223	132	129		900	
Nuclear decommissioning	138	230	229	229	160	159	160	161	1.328	17%
Life Long Learning + Erasmus Mundus	676	852	920	960	980	990	1.020	1.030	6.752	52%
7th Research framework programme	5.044	5.170	5.612	6.088	6.704	7.486	8.170	8.851	48.081	75%
Competitiveness and innovation (CIP)	339	407	420	440	468	493	514	542	3.284	60%
Progress (social policy agenda)	95	78	86	91	96	98	102	107	658	12%
CUSTOMS 2012, FISCALIS & EMCS	56	64	64	65	69	73	77	79	490	42%
Other (other actions in transport & energy safety, other social policy agenda, internal market, statistics, EIF capital increase, fight against fraud, traditional agencies & margin)	491	652	673	691	714	706	744	821	5.003	*67%*
TOTAL SUB-HEADING 1A	**7.570**	**8.404**	**9.097**	**9.754**	**10.434**	**11.295**	**12.153**	**12.961**	**74.098**	71%
SUB-HEADING 1B Cohesion for growth and employment										
Structural funds	31.682	36.152	35.789	35.448	34.816	34.537	34.718	35.063	246.523	11%
Cohesion Fund	5.904	6.711	7.529	8.414	9.044	9.536	10.005	10.279	61.518	74%
TOTAL SUB-HEADING 1B	**37.586**	**42.863**	**43.318**	**43.862**	**43.860**	**44.073**	**44.723**	**45.342**	**308.041**	21%
HEADING 2 Preservation and management of natural resources										
Agriculture: direct aids & market support	**43.735**	**43.120**	**42.697**	**42.279**	**41.864**	**41.453**	**41.047**	**40.645**	**293.105**	-7%
Rural development (a)	10.544	10.710	10.447	10.185	9.955	9.717	9.483	9.253	69.750	-12%
European fisheries fund (a)	630	539	544	551	551	553	554	556	3.849	-12%
Other fisheries programmes/actions	272	321	325	328	329	331	332	333	2.300	23%
Life+	199	227	241	255	266	278	290	304	1.861	53%
Other (traditional agencies & margin)	31	68	68	68	69	68	68	69	*479*	*121%*
TOTAL HEADING 2	**55.411**	**54.985**	**54.322**	**53.666**	**53.035**	**52.400**	**51.775**	**51.161**	**371.344**	-8%
SUB-HEADING 3A Freedom, security and justice										
Solidarity and the management of migration flows	393	275	343	407	440	531	671	852	3.517	117%
Fundamental Rights and Justice	35	67	69	71	68	68	69	69	482	96%
Security and Safeguarding Liberties	12	55	62	82	95	116	121	123	654	967%
Other (SIS, VIS, Eurodac, European Migration Monitoring Observatory, traditional agencies & margin)	*88*	*204*	*216*	*230*	*307*	*335*	*339*	*346*	*1.977*	*294%*
TOTAL SUB-HEADING 3A	**528**	**600**	**690**	**790**	**910**	**1.050**	**1.200**	**1.390**	**6.630**	163%
SUB-HEADING 3B Citizenship										
Health and consumer protection (incl. agencies)	139	138	164	179	181	182	184	185	1.214	33%
European Culture and Citizenship (Culture, Youth, Citizens for Europe)	176	179	187	193	193	193	193	193	1.330	9%
Media	91	81	95	97	98	99	99	99	671	9%
Rapid response and prep. Instrument for major emergencie:	17	15	17	17	17	17	17	17	119	1%
Institution building (Bulgaria and Romania)	66	82							82	-100%
Other (Information policy , Eur. Year intercultural dialogue, pilot projects citizenship, EU visitors, traditional agencies & margin)	105	104	105	103	103	103	103	104	724	-1%
TOTAL SUB-HEADING 3B	**591**	**599**	**568**	**590**	**593**	**595**	**597**	**598**	**4.140**	1%
HEADING 4 The EU as a global partner										
Instrument for Pre-Accession (IPA) (b)	1.121	1.193	1.290	1.353	1.452	1.565	1.660	1.700	10.213	52%
Eur. neighborhood & Partnership Instr. (ENPI)	1.274	1.390	1.400	1.437	1.470	1.530	1.640	1.720	10.587	35%
Development Coop & Ec. Coop Instr. (DCEC)	1.862	2.000	2.060	2.116	2.167	2.190	2.246	2.324	15.103	25%
Instrument for Stability	531	232	268	338	363	400	430	500	2.531	-6%
Common foreign and security policy	99	150	185	220	250	285	310	340	1.740	245%
Provisioning of Loan Guarantee Fund	220	188	185	181	178	174	171	167	1.244	-24%
Emergency aid reserve	221									*-100%*
Other (humanitarian aid, macro-financial assistance, ad-hoc envelopes, traditional agencies & margin)	894	1.046	1.081	1.094	1.129	1.196	1.222	1.278	8.046	43%
TOTAL HEADING 4(b)	**6.222**	**6.199**	**6.469**	**6.739**	**7.009**	**7.339**	**7.679**	**8.029**	**49.463**	29%
HEADING 5 Administration	**6.499**	**6.633**	**6.818**	**6.973**	**7.111**	**7.255**	**7.400**	**7.610**	**49.800**	17%
HEADING 6 Compensation	**1.041**	**419**	**191**	**190**					**800**	
TOTAL	**115.448**	**120.702**	**121.473**	**122.564**	**122.952**	**124.007**	**125.527**	**127.091**	**864.316**	10%

NB: All figures have been calculated using a 2% annual deflator between 2004 and 2013.

* The European Development Fund, the EU Solidarity Fund and the Emergency Aid reserve are not included in the financial framework.

(a) The 2006 level excludes the 2001 technical adjustment to the ceilings of structural actions heading whereby € 1026 million were shifted to the year 2006 to take account of the implementation conditions of structural funds. This affects all the transfers from the current structural actions to the new Heading 2.

(b) The 2006 figure does not include appropriations for BG/ROM nor the amount (€ 134 mn) proposed for 2006 by the Commission for the northern part of Cyprus.

(c) The breakdown for the year 2006 is based on the 2006 budget.

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