THE EUROPEAN UNION'S GENERAL BUDGET- AN INSTRUMENT FOR ECONOMIC GOVERNANCE

Tatiana COVALSCHI*
Lilia ROTARU**

Abstract. *The European Union is an unprecedented institution in the world, and therefore the general budget of the European Union is a specific budget, different from the national public budgets or the budgets of different organizations. This article studies the peculiarities of the European Union general budget, its essence and role in the economic governance, as well as the position of this budget in European financial system. The article is based on a complex analysis of the revenues and expenditures of the general budget of the European Union and of the interconnections between the general budget and the budgets of the Member States, in order to ensure the sustainability of public finances in the European Union at present.*

Keywords: European financial system; EU general budget; economic governance
JEL Clasification: F36; F42; H87

Introduction

An economic crisis is a test that enables the identification of weaknesses within the economy. The global economic crisis, which started in 2007, degenerated into a sovereign debt crisis in the Member States of European Union (EU) in 2009. It has demonstrated that there are certain problems regarding the functioning of the European financial system that need to be solved. European authorities' response to the crisis was to tighten fiscal discipline in the Union. Subsequently, today the European Union's economic governance framework aims to detect, prevent and correct problematic economic trends such as excessive government deficits or public debt levels, which can stunt growth and put economies at risk. The support of the European economies that were facing difficulties was the second item on the anti-crisis measures' agenda. Only in 2010, two years after the economic crises had started, the EU responded to the sovereign debt crisis by setting up temporary support mechanisms for its Member States, which was replaced by the permanent European Stability Mechanism (ESM) in 2013. Why did this happen? The explanation resides in the fact that the European public finance is a unique, but still an emerging construction, that first of all needs to be enhanced. One characteristic the European financial system is the small size of the EU general budget, which did not allow the European authorities to intervent more promply and hence has led to a delayed reaction to the crisis. Another important peculiarity is that the budgetary policies of the Member

* PhD student, university lecturer, Finance and Banking Department, Faculty of Economic Sciences, Moldova State University, e-mail: tatiana.vishanu@yahoo.com
** PhD, associate professor, Finance and Banking Department, Faculty of Economic Sciences, Moldova State University, e-mail: rotarulilia@inbox.ru

States are descentralized. This aspect of the European public finance is particularly important for the sustainability of the entire European construction as Governments of the Member States that are included in the euro zone have already given up monetary policy instruments to influence the economy and this means that abandoning fiscal policy instruments would violate states' sovereignty.

Economic governance reflects how decisions regarding the European economy are taken and implemented by the Community's authorities. It is well known that the public budget is the main instrument through which governments regulate the economic life within a state, but as it was stated before, the EU general budget is much smaller than the national budgets. According to the European Commission Report on the execution of the EU budget, the budget's expenditures in 2013 ammounted approximately 143,8 billion euro. Comparing to total national budgets of 28 EU member states, which according to Eurostat in the same year amounted over 6,4 trillion euros, it is a small sum (more than 44,6 times less). Reported to Member States' GDP the EU budget was of about 1,1% at the end of 2013, while the size of the Member States national budget is almost half of GDP (according to statistics, ten countries out of 28 Member States recorded a level of public expenditure exceeding 50% of GDP in 2013, while this indicator for the entire EU area was of 49,1%). The small size of the EU general budget raises concern about the impact of fiscal and budgetary decisions on the European economy and questions about the role of the general budget in the EU economic governance. For example, Tache (2014, p.18) argues that the low level of EU budget reflects the limited of role of public finances in the European economic governance and the strong significance of regulating public finance of the Member States. That is why the main question addressed in this paper is whether the increase of the EU general budget's size could be a good solution to enhance the European financial system? The response to this question is given by analysing the genesis, the main features and the structure of the EU general budget.

1. Literature review

EU general budget is constantly in the center of public opinion and is an important subject for academic studies because it is the most important public financial fund in the EU. Most studies and analises dedicated to this subject are the publications of the European Commission. The seminal paper of the European Commission is the handbook on European Union Public Finance (2014) that contains comprehensive information about the evolution of the European Pulic Finance, including the genesis of the general budget of the EU, the general budget's revenues and expenditures, the system of own resources, budgetary principles and the budgetary process at the EU level. Many academic researches are inspired from this paper, but examine narrower aspects on the European budget: Covalschi (2014), Firtescu (2013), Popa *et al*. (2012) etc.

The sovereign debt crisis of the EU Member States has raised concerns about the need to reform the European public finance system, including the European budget. These conclusions can be found in many scientific works, like those of Dabrowsky (2013), which examines the general EU budget as one element of European fiscal integration, the research conducted by the Center for Financial and Monetary Research, „Victor Slavescu", by Padurean *et al*. (2012), which examines the sustainability of the budget's expenditures, or the study of Lazea *et al*. (2012) on reforming the system of own resources and the opportunity to introduce a Community tax.

Despite the fact that there were previous researches devoted to the European budget this paper complements this literature as we aim to study the EU general budget more indepth, namely as a part of the European financial system and as an instrument of the economic governance mechanism at the EU level.

2. Methodology and data

The study performed in this paper is based on the statistical data of the European Commission's from the EU budget Financial Reports and the information published on the Commission's official website. This article assumes a comprehensive study on the evolution of the Community budget since 1958 until nowadays. In this paper the revenue and expenditure indicators of the EU budget were analyzed. As analytical methods, synthesis, deduction, graphical method, structural and system analysis were used.

As Pietras (2011) stated, it is not appropriate to apply the same methodology to analyze the EU budget as the one applied to national budgets. A simple analysis of the structure of budget revenues and expenditures used to assess national budget or the budget of an international organization is not enough because the EU budget is different. This is why in this paper we have applied a special approach by analyzing the budget in line with the development of the main European public policies.

3. The genesis and essence of the European Union general budget

In order to support the implementation of the European policies and to exist as a separate subject in terms of international law, EU needs financial resources, reflected in an EU budget that provides substance to the European integration. The EU general budget was estalished following the development of the EU as a political and economic space. Since the establishment of the first budgets for the organizations that later have founded the EU, the tendency was to unificate the budgetary instruments in a single budget, giving birth to the general budget of the EU. Hence, the creation of the EU budget was a long and gradual process (Table 1).

Table 1 - The evolution of the EU budget

<table>
<tr><th>Dates</th><th>July 24, 1952</th><th>January 1, 1958</th><th>July1, 1967</th><th>January 1, 1971</th><th>July 23, 2002</th></tr>
<tr><td>Event</td><td>The entry into force of the Treaty of Paris</td><td>The entry into force of the Treaties of Rome</td><td>The entry into force of the Merger Treaty</td><td>The entry into force of the Luxemburg Treaty</td><td>The expiry of the Paris Treaty</td></tr>
<tr><td rowspan="5">Budgets</td><td colspan="4">ECSC operating budget</td><td rowspan="5">EU General Budget</td></tr>
<tr><td colspan="2">ECSC administrative budget</td><td rowspan="3">EEC general budget</td><td rowspan="4">EEC general budget</td></tr>
<tr><td></td><td>EEC budget</td></tr>
<tr><td></td><td>Euratom administrative budget</td></tr>
<tr><td></td><td colspan="2">Euratom research and investment budget</td></tr>
</table>

Source: Elaborated by the authors

Thus the budgets of the communities that have preceded the EU stood at the base of the EU general budget. The EU budget was formed by the merger of the budgets of three communities: European Coal and Steel Community (ECSC), the European Atomic Energy Community (EAEC, better known as Euratom) and the European Economic Community (EEC). Today we can say that „the EU general budget is a document that stipulates and authorizes the estimated amount of revenues and expenditures required for the functioning of the EU each budget year" (Saguna and Tofan, 2010, p.115).

At the same time the EU budget can be seen as a unit of Community's financial funds necessary to finance measures and actions included in common policies. However, the Community's system of financial funds consists of two categories of funds: budgetary funds to cover general budget expenditures and annex funds that are apart from the EU budget. At present extrabudgetary expenditures are included under the European Development Fund, the only extrabudgetary fund. All the other funds that in the past existed apart from the EU budget were gradually integrated in the general budget.

Although it is smaller than a national budget, the planning the EU budget is a much more laborious process, involving several institutions. The European Commission prepares the draft budget. Subsequently, the budget is decided by politicians elected in the European Parliament and the Council, where all Member States are represented. European public expenditures are planned on a long perspective. EU's annual budget is prepared respecting fixed budget ceilings for certain periods of time, as preparation of annual budgets is preceded by the adoption of the „financial perspectives”. Originally EU spending projections were made for three years, since 1984 multiannual forecasts included a 5 years time period and since 2000 „financial frameworks”, with duration of 7 years are being developed.

4. Revenues of the general budget

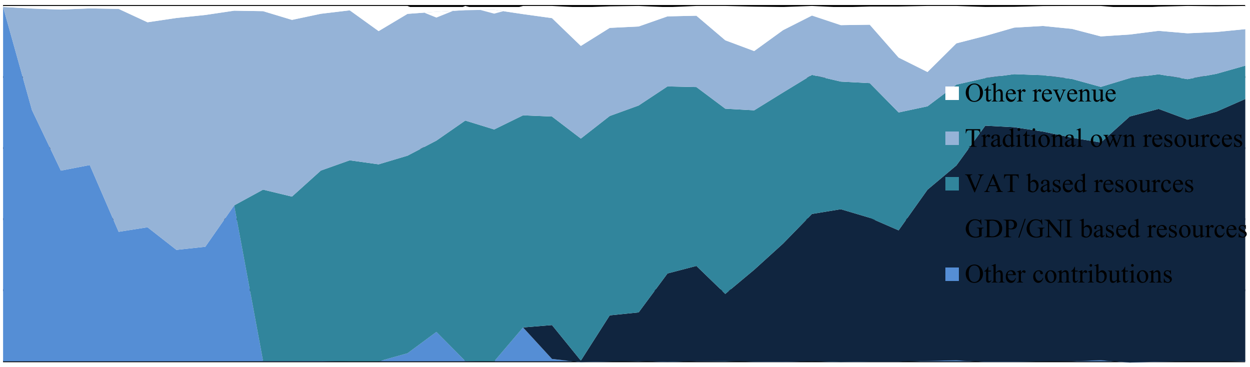
In order to talk about the role of the general budget as a management instrument at the Community's level it is necessary to analyze the essence of this financial fund by observing the way it is formed and subsequently distributed, the typology of net contributor and recipient countries.

As regarding to the Community's budget revenues, „at the beginning of the European Community the budget represented a financial instrument similar to the one of traditional international organizations” (Tache, 2014, p.16). At present unlike a state budget, which is financed mainly from tax revenues, the EU budget is financed largely from resources based on gross national income (GNI), which represent a contribution of Member States to the EU budget basing on their economic power. However, unlike classical international organizations, which as a general rule obtain their resources from the contributions of their member states, the EU budget's resources are supplemented from the revenues collected from its own tax system, introduced since 1971 called the system of own resources. This resources include „traditional” own resources (customs duties and agricultural levies), resources based on GNI and VAT-based resource. So, in terms of revenues, EU budget can be considered a hybrid budget between a national budget and the budget of an organization.

Unlike the structure of the resources that form national budgets, the Community's budgetary resources do not include resources from loans, so that every euro spent from this budget is not spent in advance. This means that the principle of budgetary balance is strictly observed. Unlike the budgets of the Member States, where the budget deficit can go up to 3% of GDP, the EU general budget must be balanced or in surplus. Thus, the elaboration of the EU budget starts from estimating costs, after which revenues collected from customs duties, agricultural levies and VAT- based resources are calculated. The uncovered balance between own revenues and total expenditure is splited between all Member States in the form of a percentage of GNI. Subsequently, GNI contributions are included in the drafts of the national budgets by each Member State and then paid to the EU budget. In order to examine the role of each group of resources in financing the UE budget we will further examine the structure of the EU general budget revenues basing on Figure 1.

As it can be seen in Figure 1, in the last years, own resources, excluding GNI based resources, are far from being enough to cover the total budget expenditures and their importance in financing the Community budget has declined significantly since their establishment. Thus, traditional own resources had covered more than half of the EU budget in the ‘70 (reaching a peak of 62,7% in total revenues in 1974). Lowering taxes on international trade has led to the gradual reduction of their share in the budget. The VAT-based resource was initially of 1% from the national VAT but it was gradually reduced to 0,3% (and less for states who are granted rebates). VAT-based resources have provided the largest share of the EU budget revenues during the period between ‘80 –‘90. The largest contribution of the VAT resource of 67,7% in total revenues was recorded in 1986. At present the GNI resourse is the main resource in the general budget.

Figure 1 - Revenues of the EU general budget in the 1970-2013 period



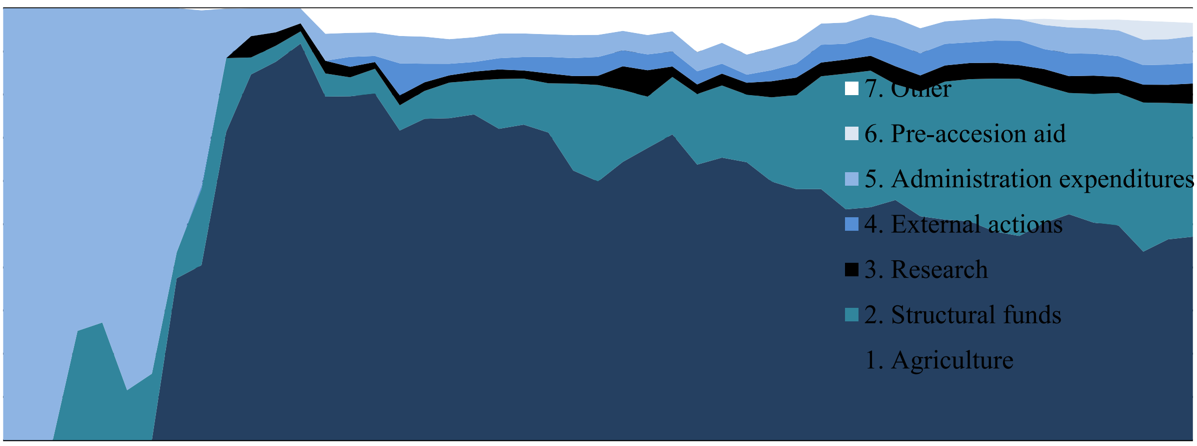
Source: Prepared by the authors basing on data from the European Commission Financial Reports for 2008 and 2013

The structure of revenues of the adopted budget for 2014 keeps the trend of the last years. In 2014 traditional own resources represented 12,04% of the approved budget financing, the VAT resource was planned to cover 13,20% of the budget, while 73,63% of the budget revenues were estimated to be obtained from collecting GNI resources. The conclusion is that this kind of revenues’s structure reflects a dependence of the European budget on the national budgets of the Member States and thus could create tensions among Member States. That is why we agree with the opinion that the introduction of a new tax resource is absolutely necessary to solve this problem.

5. Expenditures of the general budget

Regarding the expenditure side, the EU budget represents the financial base for the initiatives and projects in areas where all EU countries have agreed to act at the Union level, the common policies. An analysis of what the EU spends can say a lot about European integration priorities. The economic and financial crisis, which has led to a slowth in the economic growth, opened a new stage in the evolution of the EU budget expenditure's structure. Like it was said before the EU general budget can be seen as a system of funds designed as financing instruments for common policies in different areas. Consequently until 2006 the classification of the budgetary expenditures reflected the main funds destinated for financing different actions. For example the general budget included expenditures for the European Agricultural Guidance and Guarantee Fund – Guareantee Section, designed to sustain the Common Agricultural Policy (CAP) and the Structural Funds destinated to finance the Regional Policy. Besides them the budget included expenditures for research, external actions, administration, pre-accesion aid and other expenditures. Within the 2007-2013 financial perspectives the EU countries have decided to devote a considerable part of the joint efforts and of course of the EU budget for sustainable growth, which at present has become one of the main priorities of the Union. At the same time it involved a reform concerning the general budget expenditures. New categories of expenditure substituted the traditional ones. This new expenditure grouping expresses ambitious objectives of Community's policies like competitiveness for growth and employment; cohesion for growth and employment; preservation and management of natural resources, citizenship, freedom, security and justice; the EU as a global player and administrative expenditures. For this reason the analysis of the EU budget's expenditures was performed for two periods of time, namely the period before and after 2006. The analysis of expenditures in the period 1958-2006 can was conducted basing on the data from Figure 2.

Figure 2 - The expenditures of the EU general budget in the 1958-2006 period



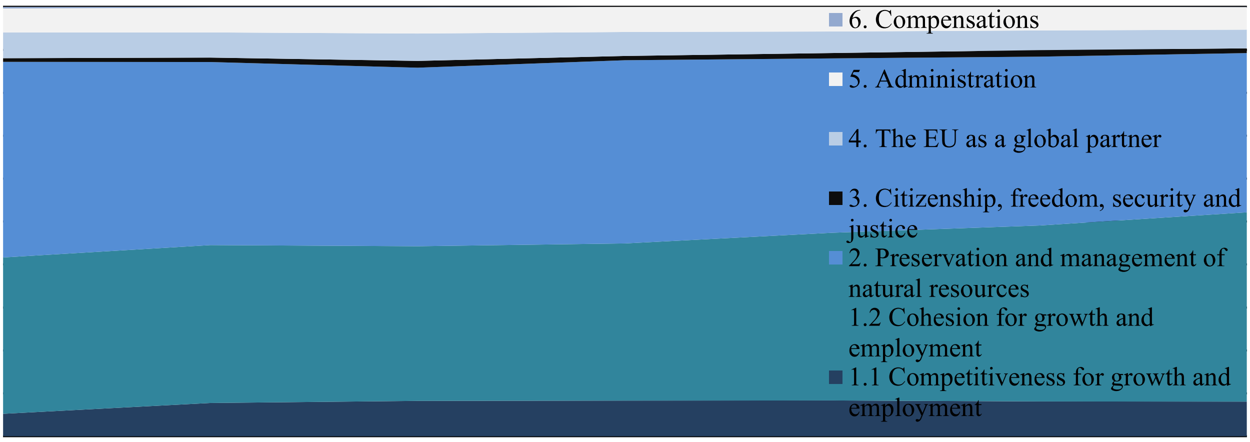
Source: Prepared by the authors basing on data from the European Commission Financial Report for 2008

From the figure above we can see that the most important policy areas financed by the EU general budget until 2007 were the Common Agricultural Policy and the Regional Policy, the amount of the expenditures for these politics represented about 78% of budgetary expenditures in 2006. Agriculture was the sector that has absorbed most of the budget resources for a long period of time because it was the area for which a common policy was applicated since early stage of European construction, as it was born in 1962. Under this policy the money is spent to ensure affordable food for EU citizens and a fair standard of living for farmers. Expenditures for agriculture recorded the highest share of total spending in 1970, when they accounted for 91,8%. This fact has created important problems in relations between Member States and has led to the rebate that was granted to the United Kingdom by the the Fontainebleau European Council in 1984. Afterwards it gave rise to a series of associated correction mechanisms to placate objections from other member states and that have made the financial relations with the EU budget very complicated. At present these expenses decreased as a percentage as new common policies developed, but also due to a revision of the CAP. According to the information published on the official website of the European Commission direct aid to farmers and agricultural market accounted only 30% of the budget in 2013, and rural development expenditure 11%, that is 41% as a sum, comparing to 47% in 2006. The downward trend is planned to be continuing in the next years. Accordind to Boulanger and Philippidis this (2015, p.119) for the 2014–2020 period the nominal expenditure cuts will be of 13% in pillar 1 (market measures and direct payments) and 18% in pillar 2 (rural development measures).

Another important area of EU budgetary expenditures is represented by the structural funds, aimed to sustain the regional policy, also known and as the cohesion policy. Regional Policy is delivered through three main funds: the European Regional Development Fund (ERDF), the Cohesion Fund (CF) and the European Social Fund (ESF). Together with the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF), they make up the European Structural and Investment (ESI) Funds. In 2006 these funds amounted almost 31% of total budget expenditures. This policy aims a real convergence between economies and regions undergoing the integration process and ensures optimal functioning, balancing and promoting a harmonious development in terms of minimum economic and social costs. Thus, even if the EU's general budget has a small budget size, expenditure on cohesion policy makes it very important. The Regional Policy is also the EU's main investment policy. According to the information published on the official website of the European Commission for 2007-2013, cohesion policy has created nearly 600,000 jobs and supported close to 80,000 business initiatives. It has invested in 25,800 kilometers of roads and 2,700 thousand km of railway lines. This policy helped 5,7 million people find jobs and 8,6 million to obtain qualifications.

The recent evolution of the Community's budgetary expenditures is presented in Figure 3. The analysis of data for this period of time allows us to conclude that during the past seven years the largest part of EU budgetary resources were destinated to finance the expenditure for stimulating economic growth, jobs creation and reducing economic disparities between different regions of the EU. Agriculture, rural development, fisheries and environment expenditures have also important quotas. The same policy priorities will be followed and in the next seven years. Thus according to the adopted 2014-2020 financial framework the structure of the Community's budget expenditure is the following: competitiveness and cohesion (47,0%), followed by spending on sustainable growth (38,9%), administrative expenses (6,4%), EU presence in the world (6,1%) and expenditure on security and citizenship (1.6%).

Figure 3 - EU general budget's expenditures in 2007-2013

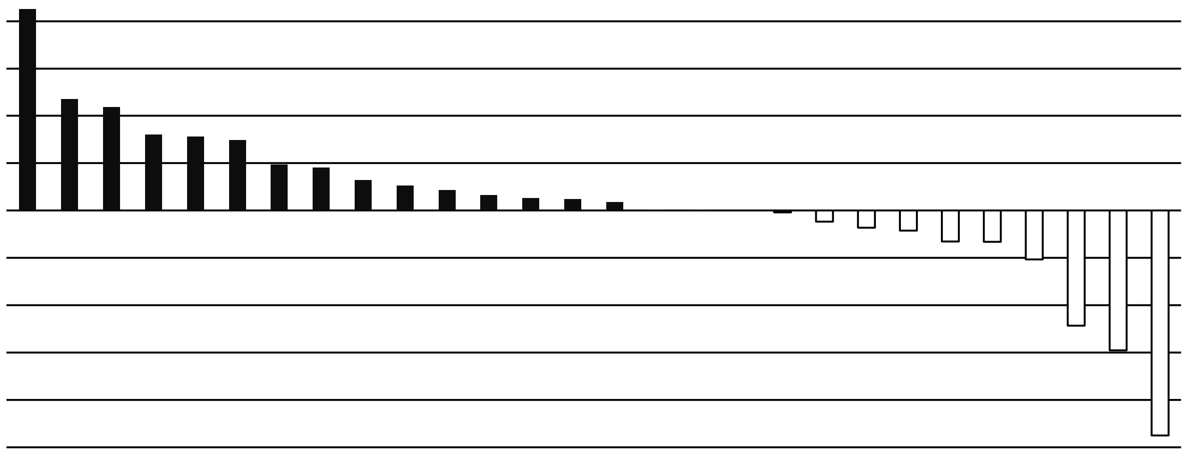


Source: Prepared by the authors basing on data from the European Commission Financial Report for 2013

In conclusion we can say that since 1958, when the entire EEC budget was intended only for administrative expenses, today's EU budget structure is very diverse and finances actions such as energy, transport, information and communication technologies, climate change, research etc. There are other areas where the EU countries decided not to act at Union level. For example national social security, health or education are funded by national governments, regional or local. Therefore we can say that the budgets of the Member States and EU general budget form together a real budgetary system with co-ordinated inter-relations. The revenues of the EU general budget are based on the resources transfered from Member States' budgets and are used to finance those policies within the Union that bring returns to scale. However, the fact that a wide part of the budgetary revenues come from GNI resources basing on the countries' economic power and the fact that a large part of the EU budget is destinated to finance the Regional Policy that aims to support less developed regions leads us to the thought that the EU budget is dominated by transfer of funds between countries. To sustain this finding we will further analyze the net contributors and beneficiaries, by examining the average operating budgetary balance for the last 7 years (Figure 4).

From the data in the Figure 4 we can see that Poland, Greece, Italy, Portugal and Spain are the main beneficiaries of the EU general budget, while Germany, France, Britain and the Netherlands are the main contributors. Thus it is clear that the EU general budget performers the redistribution of finances among European countries. However, the waves of enlargement in 2004 and 2007, which increased the economic diversity of the Member States, the economic crisis that started in 2008 and has deteriorated the condition of national public finace, as well as the constraints imposed by new austere regulations of national public finances, made this redistribution to be critised by the states that are contributors to the budget.

Figure 4 - Average operating budgetary balances for 2007-2013, mil. Euro



Source: Prepared by the authors basing on data from the European Commission Financial Report for 2013

The Member States are often tempted to just calculate the costs and benefits related to the EU budget without taking into account the economic benefits created by the consolidation of the European single market. Despite the fact that there are no loser states of EU integration, because even the net countributors obtain much more benefits from the consolidation of the single market, this fact creates tensions among Member States. That is why the EU general budget growth in size could give more power to Eurpean authorities to intervent in the stabilization of the European economy, but it is a real chalendge. More than that, we believe that modern democratic governance does not mean taking decisions from the center, but it is rather a down to top approach. We believe that strengthening the coordination mechanism of national public policies is a much more adequate solution rather than centralizing the power.

Conclusions

In conclusion we can say that the EU general budget is a reflection of the evolution of the idea of European integration. Since 1958 it has gradually increased in size, due to the consolidation of European financial funds and the growth of the size of the European area by incorporating new members. EU general budget underwent major transformations, both on the revenue and the expenditure sides to strengthen its position in the financial system of the European Union. However the EU budget remains dependent on the resources of Member States’ budgets and it is also too low to be the most important instrument of economic governance. However, small doesn’t mean unimportant. The cohesion policy that is supported from the EU general budget makes this budget to represents a symbol of solidarity among European countries, but it also creates and difficulties in relations between Member States. The existence of inter-relationships between Member States’ national budgets and EU general budget through the GNI based resources as well as and the differences in the expenditures’s structure of the general budget comparing to national budgets allows us to see that these budgets are actually complementary and interdepent as they form an EU budgetary system. We believe that the raise of the EU general budget is a very difficult issue that could be realized only as a long term goal, as not to generate conflicts and tensions among Member States. It should start first of all with neutral tax revenue at the EU level. Until then we believe that it is important to promote fiscal cooperation that would exclude nationalism and competition among Member States. In this context, recent reforms to strengthen economic governance in the EU, through the practical application of the European Semester instrument is an important step forward.

Acknowledgements

European Commission through the ERASMUS MUNDUS Programme, IANUS project has supported this research.

References

Allen, R. and Tommasi, D. (2001), *Managing public expenditures. A reference book for transition countries*, OCDE, Paris, available at: http://www1.worldbank.org/publicsector/pe/oecdpemhandbook.pdf (accessed 28 April 2015)

Altar, M., Necula, C., Dumitriu I. and Bobeica, G. (2012), *European Semester: ensuring sustainable economic growth through sound public finances. Lessons for Romania from the public finances' sustainability point of view*, European Institute of Romania, Bucharest

Baldwin, R. and Wyplosz, C. (2006), *Economia Integrarii Europene* (*European Integration Economics*), Economic Publishing House, Bucharest

Bordo, M.D., Markiewicz, A. and Jonung, L. (2011), "A Fiscal Union for the Euro: Some Lessons from History", NBER Working Paper, No. 17380, available at: http://www.nber.org/papers/w17380.pdf (accessed 12 April 2015)

Boulanger, P. and Philippidis, G. (2015) "The EU budget battle: Assessing the trade and welfare impacts of CAP budgetary reform", Food Policy No.51, pp.119–130

Covalschi, T. (2014), "Finantele publice europene: evolutie si continut (European public finance: evolution and content)", Studia Universitatis, Economic and exat sciences series, nr.7(77), 2014, Chisinau. pp. 44-50.

Dabrowski, M. (2013), "Fiscal or Bailout Union: Where Is the EU/EMU's Fiscal Integration Heading", CASE Network Studies & Analyses No. 466, available at: http://www.case-research.eu/sites/default/files/publications/CNSA_2013_466.pdf

European Commission (2009), "EU budget 2008 - Financial Report. Publications Office of the European Union, Luxemburg", available at: http://ec.europa.eu/budget/library/biblio/publications/2008/fin_report/fin_report_08_en.pdf (accessed 26 March 2015)

European Commission (2010), "European Union budget at a glance", Publications Office of the European Union, Luxemburg, available at: http://ec.europa.eu/budget/library/biblio/publications/ glance/budget_glance_ro.pdf (accessed 26 March 2015)

European Commission (2014), "EU budget 2013 - Financial Report. Publications Office of the European Union", Luxemburg, available at: http://ec.europa.eu/budget/financialreport/2013/lib/ financial_report_2013_en.pdf (accessed 26 March 2015)

European Commission (2014), "Analysis of the budgetary implementation of the Structural and Cohesion Funds in 2013", available at: http://ec.europa.eu/budget/library/biblio/documents/2013/sf_implem_rep_2013_en.pdf (accessed 27 March 2015)

European Commission (2014), "European Union Public Finance", 5th edition, Publications Office of the European Union, Luxemburg, available at: http://ec.europa.eu/budget/library/biblio/publications/2014/EU_pub_fin_en.pdf (accessed 26 March 2015)

Firtescu, B.N. (2013), *Finante publice europene* (European public finance), Tritonic Books, Bucharest.

Lazea, V.(coord.), Anghel L. and Biris G. (2012) *Prioritisation of EU policies in the light of the produce benefits they produce for Romania, in perspective of participation in the negotiations conducted within the process of the EU budget revision (Prioritizarea politicilor Uniunii Europene prin prisma avantajelor produse de acestea pentru Romania, in perspectiva participarii la negocierile desfasurate in cadrul procesului de revizuire a bugetului comunitar)*, Economic Publishing House, Bucharest.

Padurean, E., Dinga, E., Pop, N., Ionescu, C., Leonida, I., Campeanu, E., Gyorgy, A., Vorniceanu, M., Gherghina, R., Postole, A., Bercu, A.M., Preda, F., Padurean, A., Buga, E. (2012) "Perspectivele guvernantei financiare a Uniunii Europene - sustenabilitatea cheltuielilor bugetului European (Prospects for EU financial governance – sustainability of the European budget expenditure)", *Financial Studies*, Academia Romana, Institutul National de Cercetari Economice „Costin C. Kiritescu", Centrul de Cercetari financiare si Monetare „Victor Slavescu, Vol. 1 (55), p. 7-16.

Pietras, J. (2008), *The future of the EU budget. In search of coherence of objectives, policies and finances of the Union*, Centre for European Strategy, Varsovia

Popa, I., Parpandel, D. and Codreanu, D. (2012), "EU budget reform in the context of the current economic crisis", *Theoretic and Applied Economics*, Vol. XIX, No. 10(575), p. 118-129.

Saguna, D.D. and Tofan, M. (2010), Financial and fiscal European law *(Drept financiar si fiscal European)*, C.H. Beck, Bucharest.

Šimović, H. (2005), "The European Union budget", *Financial Theory and Practice*, No.29, pp. 245-262, available at: http://www.fintp.hr/en/archive/the-european-union-budget_216/ (accessed 10 February 2015)

Tache, I (2014), *Economic European Policies (Politici economice europene),* Economic Publishing House, Bucharest.