

**CORVINUS UNIVERSITY OF BUDAPEST**

**Summary of Thesis**

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**Member States and the Budget of the European Union**

**The approach focused on net balance**

**Supervisor:**

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Budapest, 2020

**International Relations**  
**Multidisciplinary Doctoral School**

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# 1. Subject of the thesis

Member States' net positions vis-à-vis the EU budget is a very popular topic among academics and politicians alike. It was in the end of the '90s that scholars turned to this subject.

The European Commission published its first assessment on the functioning of the system of own resources in 1998. In this report, the preparation of which was long awaited by net contributor Member States, the Commission published its methodology and estimations regarding the budgetary net positions and concluded that a group of Member States faced severe imbalances against the EU budget. By publishing its calculations, the Commission overturned a taboo, leading to a widespread use of net positions by national leaders and researchers alike.

Another stimulus during the 2000s was that the Commission announced a major consultation on the mid-term review of the 2007-2013 Multiannual Financial Framework, allowing many researchers and politicians to comment on the common budget.

As a result, there is now extensive literature on the net budgetary balance.

In my view, however, much of the research attempts to address the same issue: the overwhelming majority of authors examine the question with a view to invent possible reforms capable of eliminating the Member States' focus on the net balance. While I do not deny the adequacy of normative, exploratory analyses, my dissertation takes a different approach.

This dissertation is based on the following hypothesis: when designing the EU budget, the primary concern for Member States will always be to ensure an advantageous net balance. There are a number of explanatory factors behind this phenomenon, which make Member States continue to focus on net balances. By observing these factors it can also be noted that some of the reasons behind this approach overlap, thereby reinforcing each other.

Therefore I am convinced that the likelihood of a major budgetary reform is very low. Even if there appears to be some kind of reform, it will not eliminate Member States' focus on their net positions.

As regards scientific performance, the dissertation produces novel scientific results in at least two respects.

On the one hand, the method of proof can be considered novel. I try to use the most realistic approach possible to understand Member State motivations, instead of considering the net position based approach as a problem to be eliminated. My professional experience at the Ministry of Foreign Affairs and Trade encourages me to adopt a realistic approach throughout my research, which also takes into account the motivations of national leaders.

Second, to the best of my knowledge, the reasons behind the net position approach have not been studied extensively, so my research contributes to the elaboration of the topic by doing so. Many authors have commented on the reasons behind Member States' focusing on the net balance. Some reasons can be found in almost all papers dealing with the topic (such as the structure of expenditures or the predominance of the GNI-based resource), but other causes appear only in the works of a couple of authors, although they contribute greatly to the overall picture. There is clearly a lack of works which would synthesize the many factors already identified in the literature. The main aim of the dissertation is to supplement the existing scientific work in this respect.

## 2. Methods guiding the research

The hypothesis is proved mainly by using a descriptive-analytical approach. At the same time, the continuous release of data by the European Commission and the large amount of data available in the Eurostat database make it possible to support my research with up-to-date quantitative analysis.

First I introduce the basic concepts and definitions needed to discuss the topic. In addition to the practical elements, I also include historical analyses and overviews, as the whole budgetary system, but especially the Member States' net-balance-based approach, is well characterized by path dependence. On the one hand, the common budget has many features that were formed decades ago and which remain divisive for Member States (see, for example, the structure of expenditure). On the other hand, focusing on net positions has quite a long tradition among Member States (it is very common since Margaret Thatcher's stance on the British balance). Therefore, examining the tensions and difficulties of the past decades is also important for proving the hypothesis.

Next I analyse the contributions of researchers working on the net balance topic. Even though this is a scientifically young topic (roughly twenty years old), the literature on net balance is rich. Ideas outlined in previous researches provide a solid basis for proving my hypothesis, even if I am striving to take a different approach.

I pay particular attention to the rare, quantitative based works that have attempted to analyse the budget balance by including other factors in the calculations (such as the demand-raising or tax-increasing effects of EU membership).

In the next step, I examine the methodology of calculating net balances and review the concepts needed for further analysis. I provide a historical overview of recent trends in the EU Member States' budget balances: which countries belonged to the net payer and net beneficiary group and what the characteristics of their budgetary positions are. Based on these considerations, I conclude that the net contributor or net beneficiary position is relatively stable.

I place a special emphasis on explaining which Member States have been the main beneficiaries of each policy and on the prominent role these funds play for the Member States concerned.

I will then analyse in detail why the operating budgetary balance (as calculated by the European Commission) is a problematic indicator and why it cannot be considered as a good indicator of the fiscal advantages enjoyed by Member States. I study technical-statistical, economic and political aspects. I also examine sub-topics that I consider to be of special importance here, such as the European added value, solidarity between Member States and the growth-enhancing effect of cohesion policy.

Based on the above, I examine the reasons behind the Member States' approach focusing on net balances. I identify a number of economic, political, and historical causes, and then analyse how these phenomena contributed to the intensification of the net position approach. The explanatory factors I present do not provide equally strong evidence and it is clear that some factors played a role only during a limited time. However, I find it important to present all the elements that I consider relevant as to my knowledge, the reasons behind the net position approach have not been mapped exhaustively by researchers.

By reviewing the causes, I prove that many of them are interrelated, so that their effect is so strong that the net position approach is not likely to recede.

The dissertation also contains an outlook for the budgetary period starting in 2021.

### **3. Results of the dissertation**

In the first part of the dissertation I examine in detail the methods of calculating the net balances of the Member States vis-à-vis the EU budget and describe how these have evolved since 2000. I note that, despite the small size of the EU budget (which amounts to approximately 1% of EU GNI), in some beneficiary Member States EU subsidies represent a substantial net source of up to 3-4% of national income.

This is accomplished by the EU budgetary system in such a way that the financial burden on net contributors is proportionately lower. The positions of net payer countries remain below 1% of their GNI, while on the beneficiary side we can find positions of more than 3-4% of GNI.

Based on these, I reach the following conclusion.

- 1. The EU budget, in spite of all its shortcomings and imperfections, is in practice a well-functioning system that is able to distribute resources rather fairly among Member States.**

In order to better understand the motivations of the Member States, I examine which countries are the biggest recipients of the funds in the expenditure headings for cohesion policy and the common agricultural policy. These two are the expenditure areas where we can clearly identify which Member States have benefitted from EU funds.

I also look at the competitiveness sub-heading to see which Member States' firms and research centres have received the most EU grants. Here it is unreasonable to describe the Member States concerned as beneficiaries, as these are mainly central, Commission-managed grants with a particularly high spill-over effect. It is noteworthy, however, that in the case of competitiveness expenditure, we find that a certain group of Member States receives the absolute majority of funds almost every year as is the case for cohesion and agricultural spending.

Based on these, I make the following conclusion.

- 2. The structure of expenditures has evolved in such a way that all Member States know which headings they can expect high allocations from. This is an important explanation as to why there is no meaningful reform on the expenditure side and why we cannot expect the net balance approach to recede.**



Despite the fact that I work with a hypothesis that counts on the continuation of the net balance approach, I agree with the academics of this topic that the net budgetary balance is not suitable for demonstrating the fiscal (and other) benefits of being a Member State of the European Union. Therefore, in the dissertation I present in detail what shortcomings and problems can be identified regarding the budget balance itself and the Member State approach focusing on the budgetary positions.

- 3. The net budgetary position does not adequately reflect the fiscal advantages enjoyed by Member States because**
  - a. for some of the expenditure it is not evident which Member State can be considered as a beneficiary**
  - b. the calculation methodology does not take into account administrative costs, but includes several simplifications to make the data easier to use**
  - c. the calculation does not reflect the growth-stimulating effect of cohesion aid, the investment surplus generated by financial instruments or the growth and jobs expected from the Single Market.**
  
- 4. The Member States' net balance approach is detrimental because it does not take into account the added value of EU spending and the political benefits of integration, such as peace and stability or solidarity between Member States.**

I argue in the dissertation that if there is no chance to move away from the net balance approach it is because too many, often mutually reinforcing, causes can be identified behind it. To prove this, I will analyse in detail the explanatory factors, including those already mentioned in the literature. Where possible, I support my views with statistical data and quantitative observations.

The main theses of the dissertation are the statements below. They point to the factors that make the net-balance approach an evident strategy for Member States that cannot be suppressed.

**5. The net balance approach is unlikely to recede because Member States are too attached to their fiscal sovereignty.**

Most national leaders are against introducing new own resources or strengthening the role of supranational institutions (Commission, European Parliament) in budgetary matters. Therefore, they have forged a decision-making system that ensures (through the right of veto) that their sovereignty is preserved and that the arguments they put forward are taken into account.

**6. The net balance approach is unlikely to recede because of the characteristics of the decision-making system.**

The decision-making system, set up in 1988, is considered to be Member State-centered, in which the European Commission is only the initiator and the European Parliament has a right of consent. In the Council, Member States decide unanimously on the multiannual financial framework, which means that they can insist on their position.

The control of the revenue side by Member States is particularly strong, as the adoption of the own resources decision is subject to ratification by the Member States.

During the negotiations on the multiannual framework, Member States organize themselves into interest groups for a more effective representation of interests.

**7. The net balance approach is unlikely to recede because of the characteristics of the revenue side.**

The GNI-based own resource ensures approx. 60% of the revenues (the exact distribution varies from year to year among the different sources of revenue, but the GNI-based one has reached at least 60% since 2007).

The GNI resource is much more tied to the Member States than the traditional own resources or the VAT-based revenue source. Therefore, as long as GNI-based contributions continue to play a decisive role, it is to be expected that Member State leaders will try to track the level of support that their country was entitled to in exchange for its 'dues'.

**8. The net balance approach is unlikely to recede because the overall ceiling for expenditure is not growing and because the expenditure structure has special features.**

In the dissertation I present that the total amount of expenditures (in real terms) has not increased since 2000, it has actually decreased in real terms during the seven-year period started in 2014. This was despite the fact that several new Member States have since joined the Union, the number of common objectives has increased and there have been serious challenges in both economic and security terms.

The scarcity of funds encourages Member State leaders to ensure that their previously reached levels of support are not reduced.

With regard to the expenditure structure, I examine which areas receive the most EU funding. It can be stated that the Common Agricultural Policy and the Cohesion Policy represent the largest share, together these expenditures amount to ca. 70%. At the same time, these are areas of expenditure where we can clearly identify which Member States (regions) have benefitted from the funds. It is therefore a priority for all Member States to achieve the highest possible level of support through these policies.

Therefore, as long as Cohesion Policy and the agricultural policy account for a major share of expenditure, the net balance approach is very likely to continue.

**9. Political factors also play an important role in maintaining a net balance approach.**

First I examine the legacy of Margaret Thatcher. I point out that the attitude with which the United Kingdom secured a budget rebate also encouraged leaders of other Member States to provide themselves with the best possible net balance.

In the nineties, the forthcoming "eastern" enlargement was a major concern for net contributors, prompting them not to allow spending levels to rise and to ask for corrections.

The fact that since the 1990s there has been an increasing number of abuses in the use of cohesion funds has also contributed to the strengthening of the net balance approach.

Addressing Euroscepticism has become another challenge in the 2000s: Member State leaders are trying to report to their citizens that they have managed to maintain the previous level of their support from the EU budget.

**10. The economic situation also plays a major role in maintaining the net balance approach.**

During the 2000s, the economic crisis also played a major role in reinforcing the Member States' focus on the net balance.

The decline in GDP and employment, the contributions to crisis management instruments and the austerity policies implemented in many Member States have encouraged net contributors to reduce their contributions to the common budget. At the same time, the beneficiaries of the budget have become more dependent on EU funds than before and have therefore struggled to maintain their level of support.

**11. The net balance approach is unlikely to recede because the above reasons are often mutually reinforcing.**

In my dissertation I examine the explanatory factors that appear in a mutually reinforcing way and contribute to the Member States' approach focusing on the net balance.

First, the need for Member States to preserve their fiscal sovereignty largely determines the evolution of the revenue side and the way in which they decide on the budget. As a result, the introduction of new own resources or the reform of the decision-making system alone would not reduce the net position approach.

Second, the characteristics of the expenditure side increase the need for net contributor Member States to seek compensation on the revenue side. Reforming the expenditure and revenue side is therefore inconceivable without one another. However, no reform is foreseen because too many obstacles would have to be overcome at once.

Third, unanimity hinders the reform of the expenditure side, while many problems in the expenditure structure can be explained by consensus decision-making. In this case, there is a reciprocal effect.

Fourth, the difficult economic context and the rise of Euroscepticism would make fiscal reform more needed than before, but it is these factors that make Member States focus all the more on their net position.

Considering the burden of the economic crisis (management) on the Member States and the increasing Euroscepticism among the citizens, it would be important for the common budget to become more independent from Member States' contributions (through the introduction of genuine own resources) and that the Union really spends on its objectives with the highest added value. At the same time, it is precisely the domestic situation created by these factors that makes real reform impossible: in such a situation, citizens expect their leaders even more to make an advantageous deal for their own Member State.

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