Position Paper

RESTART THE EU BUDGET: "Ctrl+Alt+Del"

Control Spending

Always Think of Alternatives

Delete Inefficiencies

I. Executive Summary

This is the Executive Summary of the Position Paper that was elaborated by the signatory members of the "Coalition for a Free Europe"[1] as a response to the Communication from the Commission "REFORMING THE BUDGET, CHANGING EUROPE" 112.9.2007 SEC (2007) 1188.

The EU budget is a result of political negotiations and trade-offs between member states rather than a well grounded financing of generally agreed pan-European goals. The politicized use of EU funds distorts the motivation of market participants, harms free competition, discourages the effective allocation of limited resources, encourages corruption, contributes to higher inflation in recipient countries, raises prices of agricultural goods and brings benefits primarily to particular interest groups rather than to all EU citizens. The process of forming the EU budget faces a phenomenon known in economics as "The Prisoner's Dilemma" where each member state would be better-off financing common goals. Failing to cooperate on mutual goals and seeking to maximize their own benefits, member states end up being trapped in a situation where funds are being used inefficiently. The EU budget's "Prisoner's Dilemma" may be solved by a mutual agreement to only allocate funds for projects that bring mutual pan-European benefit. Any other use of funds should be prohibited as it returns much lower payoffs to the people of the EU. For EU budget reform, there must be a zero baseline in the beginning, with no preconceptions regarding the principles, size, revenue sources, policies and measures of the budget.

The present EU budget revenue system is too complex and the use of multiple revenue streams inefficient and unjustified. The VAT and GNI-based revenue streams overlap, causing double taxation of the value added component. The EU budget's revenue sources must be reformed and built on the following maxims: national contributions to ensure democracy; proportionality to encourage fairness and neutrality; simplicity and transparency to create accountability; and a low administrative burden to increase the effectiveness of payments.

The employment of these principles dictates the following changes on the revenue side:

1) to eliminate the VAT-based revenue stream;
2) to rely on member states' contributions based on equal proportions of GNI;
3) to diminish the financial role of the traditional "own" resources, leaving them as temporary regulatory tool and to move towards deeper liberalisation of trade;
4) to abstain from creating new sources of revenue, such as an "EU" tax. The introduction of such taxes should be banned;
5) to eliminate "corrections of payments" or rebates.

[1] The "Coalition for a Free Europe" unites fifteen leading European free market oriented think tanks. It was launched in the middle of 2006. The goal of the Coalition is to offer the EU and local governmental institutions solutions based on individual freedom, responsibility and limited government in the areas of Tax Competition, EU Budget Reform, EU Accountability and Energy Policy. The Coalition members have a long history of cooperation among themselves in different fields of economic policy. Recently the Coalition members have commented on the "Services" Directive, the Common Consolidated Corporate Tax Base and on Excise policy. In 2008, the Coalition will concentrate on Tax Competition and EU Budget Reform issues.

Policies that are funded from the EU budget are too demanding, too ambitious and thus unrealistic to achieve. Policies are incoherent and contradictory; some of them erode European competitiveness, so the aims of every policy and their consistency need profound re-examination.

The way out of this "Prisoner's Dilemma" lays in the agreement to finance only pan-European projects. Given that the single market and economic freedoms bring real and tangible benefits to all EU citizens and to all member states, and that this was the major aspiration for founding the EU, the EU budget should be strictly in line with the goal of implementing and strengthening the common market. And vice versa, no funding is justified if it hampers the free movement of capital, technology, goods, services and people. The current crisis of the budget is a result of a gradual departure away from the original values of Common Market behind the EU's foundation.

EU budget spending must go in line with the following maxims: EU funds - for EU goals; goals, not interests, ensure efficiency; financing may bring desired results, yet redistribution is a result in itself. The application of these principles implies an essential reform (and perhaps abolishment of some) of the current policies.

Cohesion can only be achieved by the removal of regulatory barriers to flexibility and free movement of factors of production within the common market, as well as the improvement of the physical conditions to free movement; thus, EU funds should focus on infrastructure that links member states together.

Competitiveness Policy should create market conditions favourable to free competition. Any public "competition" projects or publicly subsidized private (profit-seeking) projects are not acceptable. Present Competitiveness Policy includes some programs, such as the implementation of pan-European transport and energy projects that improve market conditions; therefore these programs should be included in the prospects of the new budget.

There is hardly any social and economic justification for the Common Agricultural Policy and rural development programs. The investment into creating a "good" CAP is a waste of time and other limited resources, so all efforts should focus on the creation of a sound exit mechanism, abandoning this destructive use of public resources.

On the EU budget expenditure side there is a crucial need for the following actions:

1) to create a sound exit mechanism from CAP and rural development policies and annually reduce contributions to the EU budget by the amount previously allocated to these policies;

2) to redesign the Cohesion Policy, focusing it on removal of barriers to flexibility of the markets and free movement of factors of production inside the EU market and improvement of infrastructure linking member states;

3) to abstain from financing new highly uncertain goals, such as climate change control and mitigation, Galileo, etc;

4) to rely on the private financing of innovation, research and development and not to increase present EU budget funding for these purposes;

5) to supplement the Union's external actions with the promotion of free market reforms in non-EU countries;

6) to avoid the financing of profit-seeking private companies regardless of their region, economic activity or project.

To conclude, **only the fundamental reform of the budget, not a reform of the budget's structure, may change Europe. The EU budget must be decreased if an agreement on common needs or attainable goals is not reached.**

II. Foreword

This Position Paper (further - the "Paper") was elaborated by the signatory members of the "Coalition for a Free Europe"[2] (further - the "Coalition") as a response to the Communication from the Commission "REFORMING THE BUDGET, CHANGING EUROPE" 112.9.2007 SEC (2007) 1188 final (further – the "Consultation Paper"). The goal of this Paper is to evaluate the EU Budget reform, its trends and ongoing discussions and to present EU budget reform solutions that would change Europe, make it prosperous. This Paper will focus on demonstrating how the EU budget's revenue and expenditure should be modified in order to respond to global challenges, to harmonize interests among member states, to reduce tensions during the budget's formation and to make the budget more effective and less costly. More attention will be paid to the changes needed and their merits rather than the deficiencies of the present system. How the budget is adopted, institutional reform and the question of the budget's term will not be addressed here. This Paper will be helpful to the EU institutions in preparing the official proposal of the EU reform and to national governments in forming their positions. It will also help the European citizens to recognize those solutions that would promote an economically sustainable Europe.

The Paper's structure is: one, a general evaluation of the current budget, two, a discussion of the EU budget's revenue, three, of its expenditure, and four, of its size. Throughout the Paper, important insights are underlined, the changes required for reform are suggested (proposals are in **bold)** and feedback to the main topics are presented. The Paper ends with summarized conclusions and proposals.

III. A General Evaluation of the EU Budget and the Need for Reform

"State and government are not ends, but means"
Ludwig von Mises, "Human Action. A Treatise on Economics"[3]

[2] The "Coalition for a Free Europe" unites fifteen leading European free market oriented think tanks. It was launched in the middle of 2006. The goal of the Coalition is to offer the EU and local governmental institutions solutions based on individual freedom, responsibility and limited government in the areas of Tax competition, EU budget reform and EU accountability and energy policy. The Coalition members have a long history of cooperation among themselves in different fields of economic policy. Recently the Coalition members raised initiatives on the "Services" directive, Common Consolidated Corporate Tax Base and Excise policy. In 2008 the Coalition will concentrate on Tax competition and EU budget reform issues.

[3] The quated Treatise on Economics is a part of tradition of economic thinking, which scientifically disclosured the fallacies of socialism and lead Europe out of it after the Second World War.

The EU budget is the result of a history of political negotiations and trade-offs among member states rather than a well grounded financing of mutually agreed upon pan-European targets or needs known as "public goods". The "redistribution" portion of EU funding is constantly criticized for failing to attain its goals of cohesion, growth and competitiveness. There is ample evidence of how EU funding for cohesion and agricultural policy distorts the motivation of market participants and harms free competition, discourages the effective allocation of limited resources, creates a background for corruption, preordains a lack of transparency, contributes to higher inflation in recipient countries and new member states, raises prices on agricultural goods, and brings benefits to particular interest groups rather than to all citizens.

The politicization of the budget formation process has created incentives for non-member states to seek membership in the Union[4]. Instead of uniting its members, the EU budget has degenerated into a struggle over who will become a “net-receiver” of budget funds. This has ruined the EU's declared purposes of integrity and solidarity. The difficulties undergone achieving the agreement for the 2007-2013 financial prospective prove that member states are no longer able to produce an efficient and well-directed budget merely by political bargaining. The confidence of EU citizens vanished when their politicians failed to reach a consensus on budget goals and principles, yet succeeded in sharing out the budget's pie overnight. This is a breach of trust. The European Union cannot proceed this way. It is not enough to merely have a budget representing the interests and compromises among member states anymore. Facing severe global competition, it is vitally important that the EU's resources bring pan-European benefits, not just a conglomeration of small benefits that leave everyone somewhat unhappy. If Europe goes down this road, it will definitely lose its competitiveness.

The present EU budget formation process is a case of what is known in economics as a "Prisoner’s Dilemma" where each member state would be better-off choosing financing of common EU goals. By failing to cooperate and by seeking to maximize their own benefits, member states end up being trapped in a situation where funds are being used inefficiently. The Prisoner’s Dilemma situation is neither natural nor unavoidable in the EU budgetary process. The EU budget's Prisoner’s Dilemma may and must be solved by a mutual agreement by the member states to only allocate funds for projects that bring pan-European collective benefits. Any other use of funds should be prohibited as it forces us back to the outcome with the lowest payoffs.

The EU Budget should not be a goal in itself, but an integral tool for achieving common European goals. It is crucially important to choose among financial and (de)regulatory measures those that are the most effective and the least market-distorting.[5].

The European Commission has proposed that EU budget reform should be discussed in an open manner, with no taboos. **The Coalition proposes zero preconceptions regarding principles, size, revenue sources, policies and measures as the baseline for the EU budget reform.**

[4] In addition, most economists agree that the most important benefit of the EU membership comes from the participation in the Common Market.

[5] Regulation also brings enormous compliance costs and therefore EU funding in some cases may be the lesser evil, however this Paper will not elaborate on the costs and impacts of the regulatory environment.

IV. EU Budget Revenue

“What matters is that the heavier taxation becomes, the less compatible it is with the preservation of the market economy.” Ludwig von Mises, “Human Action. A Treatise on Economics”

*The EU budget is currently financed from 3 main sources: its own "traditional" resources, customs duties, agricultural duties and sugar levies, which comprise about 15%[6] of total revenue), the VAT based revenue stream (~15 %) and a GNI based revenue stream (~69%)***.** *There is a payment correction (rebate) system that favours 5 member states (United Kingdom, Austria, Germany, Sweden, Netherlands) and which is thus supported by these five states. There is a debate on introducing a new “own” resource – an EU tax.*

The EU budget amounts to over 100 billion Euros per year or about 1% of the EU's GDP and constitutes less than 2.5% of the member states’ total public expenditure. Given these figures, the need to have numerous revenue streams is questionable from various viewpoints, including those of sufficiency and of the diversification of risks. The VAT and GNI-based revenue streams overlap, causing the double taxation of the value added component, reducing the transparency of the payments and increasing their complexity. The EU budget's financing methods needs simplification and better justification.

1. Principles of the Budget's Revenue Sources

The EU budget's revenue sources should be built on the following fundamental principles:

National contributions to ensure democracy. This principle comes from the historical tradition of European Community's founding as an association, not a federation, of independent states. This principle means that member states may contribute to the EU budget but the EU has no right to tax. This principle ensures the smoothness, stability, sufficiency and balance of the EU budget. An application of this principle does not provide justification for any taxation at the EU level in a form of an EU tax. A temporary exception may be made for the EU's "traditional" tariff revenue which may be allocated to the EU budget only because it would be problematic to distribute it fairly among the member states. Customs duties and levies should be strictly limited to regulatory purposes. No financial needs should prevent tariff reform and the abolition of customs duties.

Proportionality to encourage fairness and neutrality. The fairness principle implies that member states’ contributions should be an equal proportion of the member states' national income. The present GNI-based resource meets this principle since the contributions are based on a flat rate. This fairness principle does not allow for any "payment corrections" or "diversified contributions".[7]

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[6] 2007 budget

[7] We envision that the EU budget will eventually be financed by per capita payments. Such payments would be the least distorting revenue source, ensuring equal rights, duties and fairness while helping to create an authentic union of citizens.

Simplicity and transparency (visibility) to create accountability. The simplicity and transparency principle requires that the income source (member states' contributions) needs to be clear to public officials and to every EU inhabitant. Every country and individual has to know precisely how much they are contributing to the EU. It is not enough merely to report how much was paid to the EU budget. Every citizen should be able to make a rough estimate of his contribution based on basic information such as his member state's GDP and contribution rate. Applying this simplicity principle would ensure EU accountability and eliminate attempts to hide whether a member state is a net donor to the EU budget or a recipient. Simplicity leads to fewer mistakes and misinterpretations. A simplicity principle also implies less income sources.

A low administrative burden to increase the effectiveness of payments. The principle of a low administrative burden closely correlates with the simplicity and transparency principle, and means that the calculation and the payment of the contributions should not require numerous additional regulations or procedures. The low administrative burden principle does not, however, justify the introduction of new income sources in order to increase the EU's budget revenue[8]. Low compliance costs reduce the likelihood of mistakes while increasing transparency and the efficiency of the payments system.

By understanding these Budget Revenue principles, the relative advantages of GNI and VAT revenue sources may be compared. The GNI source appears to be better than the VAT based revenue stream because:

1) the calculation of any VAT based resource is more complex; it goes through several intermediate procedures and deviates from the actual size of VAT collected in each member state. To avoid this deviation, an absolute uniformity of VAT bases and rates would be required, which is neither desired nor realistic;
2) a uniform percentage rate applied to the Member States' GNI contributions would be proportional and fair;
3) since reliable, accurate and comparable statistics are required to calculate GNI correctly, the calculation of each contribution should be as simple as possible;
4) the GNI based revenue source is a proven, effective, and sufficient source of revenue.

In summary, the application of these Budget Revenue principles implies the following policies:

1) to eliminate the VAT-based revenue stream;

2) to rely principally on member states' contributions based on equal proportions of GNI;

3) to reduce the relative financial role of traditional "own" resources, leaving them as a temporary regulatory tool and to move towards a deeper liberalization of trade;

4) to abstain from creating new sources of revenue, such as an "EU" tax; the introduction of new taxes should be banned;

5) to eliminate the "corrections of payments" and rebates.

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[8] The latter, if inevitable, may be done by increasing present rates without complicating the existing system of contributions.

2. On the EU tax

An analysis of the ongoing discussion about the introduction of an EU tax (a European VAT, a European corporate income tax, a telecommunications tax, an energy tax, etc.) results in some strong arguments against this sort of tax:

1. An EU tax would most likely be an additional tax on top of the existing revenue sources and lead to an increase of the tax burden and would make the EU budget revenue system more complicated and less transparent.
2. The introduction of a new income source is not justified from the point of view of revenue. If the EU budget needs more funding, it would be less harmful to increase the existing rates rather than to introduce a new revenue source.
3. An EU tax would lead to deeper and broader tax harmonization in the EU; furthermore, it would create a governmental tax cartel and increase each nation's tax burden.
4. Relying on an EU tax and abolishing existing revenue sources would be counterproductive due to the difficulties in ensuring sufficient and smooth (uninterrupted) financing.
5. As an autonomous revenue source, an EU tax would undermine the independence and sovereignty of member states.
6. Contrary to its proponents' statements, an EU tax would not contribute to the Common Market: a Common Market may only be achieved by the removal of existing barriers, not by the creation of identical barriers.
7. If tax competition is not allowed freely inside the EU, then the EU will face even tougher tax competition with non-EU countries.
8. An EU tax will most likely increase anti-EU sentiments among EU citizens.

To reiterate, the **Coalition proposes to renounce the idea of an EU tax and to clearly communicate this decision to society in order to avoid vain political efforts and detrimental controversies.**

V. The EU budget expenditures

"Every step a government takes beyond the fulfillment of its essential functions of protecting the smooth operation of the market economy against aggression, whether on the part of domestic or foreign disturbers, is a step forward in a road that directly leads into the totalitarian system where is no freedom at all." Ludwig von Mises, "Human Action. A Treatise on Economics"

The EU budget of 2007-2013 financial prospective is highly redistributive and aims to pursue the following EU Policies (each policy's percentage of total expenditure is shown in parentheses):

- *Sustainable growth - Cohesion Policy (35.7%[9]) and Competitiveness Policy (10.2%);*
- *Preservation of Natural Resources - Common Agricultural Policy (32%) and Rural Development (7.3 %)),*
- *Citizenship, Freedom, Security and Justice (~1%);*
- *External Affairs (6.3%);*

Administrative expenditures are financed from the EU budget and comprise approximately 6% of the EU's budget for the years 2007- 2013. Compensations to new member states are around 0.1% of the EU budget.

Despite the fact that the EU pursues rather few policies, the programs and tools used to apply these policies are many and complex. To draw a roadmap of the myriad goals, programs, measures, funding sources and schemes involved would be nearly impossible. A complex array of horizontal and vertical goals are financed from different sources, resulting in waste and high compliance costs. Actual allocated resources are further reduced by the army of specialized consultants that has emerged in every member state; consultancies consume from 1 to 10 per cent of the budgeted amounts. Both policy guidelines and actual results frequently do not even reflect the original aim of the financing.

Overall, EU funding has failed to achieve the goals of cohesion and competitiveness. According to Eurostat, the EU-25 does not compare well with the USA; labour productivity per person employed is almost 40 per cent lower, the unemployment rate is nearly double, and GDP per capita is almost half. EU-15 data is not optimistic either. Significant economic and social differences remain among member states. Of course, these comparisons are based on highly aggregated data and these statistics do not evaluate the effects of regulation. Yet these comparisons, in general, reflect policy goals! The problem is that policies may not be aligned with their aims, or simply incoherent and contradictory. For example, Cohesion versus Competitiveness, a Common Agricultural Policy versus Competitiveness; thus the aims of every policy and their internal consistency need profound re-examination. **Policies and goals need to be sound, consistent and achievable by budgetary means. The financing structure must be in line with priorities. First and foremost, spending principles must be agreed upon.**

1. Principles of Budget Expenditure

EU budget spending should be in line with the following maxims:

EU funds for EU goals (subsidiarity). The Subsidiarity principle means that the EU should only fund projects that are pan-European, that bring tangible benefits for all Europeans. Projects that can be realized at the national level should be ineligible for EU funding. Given that the single market and economic freedom bring real and tangible benefits to all EU citizens in all member states, EU funding should be directed towards improving the single market. Conversely, no funding is justified if it hampers the free movement of capital, technology, goods, services or people.

[9] Data from the Communication from the Commission "REFORMING THE BUDGET, CHANGING EUROPE" 112.9.2007 SEC (2007) 1188 final

Goals, not interests, ensure efficiency. The EU is mature enough to outline its goals, to finance the attainment of these mutual goals and to stop supporting policies which simply help individual member states become net receivers of funds. Without a depolitization of budget spending it is impossible to form a budget that attains non-political goals. Pan–European goals must replace narrow national interests. The economic benefits of EU funded-projects must be greater than their costs.

Financing may bring results, yet redistribution is a result in itself. Economic reasoning shows allocating funds based on measurable targets is superior to simply redistributing funds to poorer regions. Allocation creates incentives to become a winning leader, not to be financed solely because you are least well-off; it sends correct signals to market participants; it creates measurable targets. So, EU funds should be allocated to those projects that bring Europe closer to its common goals. Redistribution merely for the sake of giving money to poorer countries or for the sake of compromise is unjustifiable.

Below, each major EU Policy will be evaluated and proposals will be drawn on the basis of the Budget Expenditure Principles outlined above.

2. Cohesion Policy

The Cohesion Policy is aimed at reducing social and economic disparities among the regions, protecting the environment and implementing the Lisbon Agenda to promote innovation, growth and jobs (around 62% of Cohesion Policy funds) and is pursued through European Regional Development Fund, European Social Fund and Cohesion Fund. The Cohesion policy is highly redistributive, hardly justifiable and almost impossible to adhere to (see the box below).

The goal of the social and economic cohesion policy is ambitious, but dubious:

- Is complete cohesion desirable if the European market relies on regional differences and the division of labour?
- Can this cohesion be achieved in principle?
- Is the lack of cohesion a result of barriers to the free movement of labour and other factors of production, inflexibility, etc., or it is due to the lack of EU funding?
- Can state financial intervention induce cohesion?
- What amount of funding would be sufficient to achieve cohesion?

There are no precise answers to these questions. What we know for sure is that the goals of cohesion are introverted, focusing on the EU's internal differences and unable to react to the external challenge of global competition facing the entire EU. Furthermore, the goal of cohesion contradicts the goal of competitiveness in so far as it harms the efficient allocation of resources, which often require urbanization and a higher degree of economic centralization within a country's economy. In practice, pursuing cohesion causes malinvestment and overinvestment in declining regions.

There are fundamental problems in creating cohesion:

- funds are distributed through governmental bodies whose methods cannot guarantee the allocation of money to the areas that most contribute to cohesion;
- cohesion policy promotes provincial thinking, where the mere absorption of funds becomes more important than policy goals;
- some policies, such as the CAP, contradict the goal of economic growth,

- funds flow to those regions which lobby best for them, regions are not in the poorest and least developed countries.

There are administrative and accountability flaws at the implementation level which have been repeatedly highlighted in the Annual Reports of the Court of Auditors. These flaws result in funds being widely dispersed and untargeted. Cohesion Policy sets multiple goals which diverge from the primary mission of financing less developed areas and reducing differences in development.

Cohesion policy should be limited to the removal of existing barriers to trade and the movement of people or to the creation of closer infrastructural links among member states. Since barriers to trade are of a regulatory nature, the removal of red-tape would enable member states to buy in the cheapest markets and sell to the dearest.

<u>Cohesion can only be achieved by the removal of regulatory barriers to flexibility and the free movement of the factors of production within the common market, including physical improvements promoting free movement</u>**; thus, the EU budget should focus on improving the infrastructure linking member states.**

3. Competitiveness Policy

Competitiveness Policy includes innovation, research and development, transport, energy, lifelong learning, the Galileo Project, and support for closing nuclear power stations.

Project financing is based on fund allocation, not on redistribution. Competitiveness Policy also incorporates the Lisbon Strategy which ends in 2010 - suggesting that the reformers of the EU Budget have to have a longer time horizon and possibly draw lessons from the shortcomings and mistakes of the Lisbon Strategy (see the box below).

Let us mention just two mistakes:

1) the core goals and objectives of the Lisbon strategy are not entirely coherent and compatible. This is primarily the case in attempting to create conditions for economic growth, increased competitiveness and employment, and at the same time to promote social cohesion. As long as inconsistent objectives are pursued, the strategy is difficult to implement and it remains only a rhetorical device, which under favourable political circumstances will help to mobilise the politicians of the member states for the implementation of certain required reforms or, on the contrary, is used in the discussions of domestic policy as a means for diverting criticism.
2) the objectives set in the Lisbon strategy are very diverse in their character and are directed to different addressees. Some of them are presented as shared horizontal objectives (for instance, promotion of competition), others are defined as very specific measures (for instance, a common format of curriculum vitae or a mandatory percentage of biological fuel), yet some others bypass significant areas (for example, agriculture), which, without reform, will be difficult to achieve the targets set. Often, tasks that are formally assigned to member states should be primarily directed to private companies, as state institutions have a very limited influence on the objectives of the Lisbon strategy (except issues

directly related to the public sector, for instance, the enhancement of its efficiency). All this hinders the achievement of the core goals of the strategy, because the implementation of the Lisbon objectives depends on the market response to the political decisions and their coordination; and when political decisions are sending contradictory signals, the market reaction may also be difficult to predict.

After several years of implementing the Lisbon's Strategy, it must be understood that competition is the key to competitiveness! Competition will arise only if market conditions are favourable to free competition. Any engagements in public "competition" projects or publicly subsidized private (profit-seeking) projects are not acceptable (see the box below).

The Galileo project is an excellent example of misinterpreting the concept of competitiveness and competition. The creation of a duplicate product that already exists in the market free of charge on the basis of "prestige" or "grandeur" adds nothing to the competitiveness of the EU. The argument that it is better to spend money on hi-tech rather than on agriculture enters a dangerous area which is driven not by sound economics, but by arbitrary judgment. Diverting public resources to uncompetitive products is wrong, regardless of the nature of the product.

There is an ongoing discussion in the EU about increasing financing for innovation, research and development. Research and innovation certainly plays a crucial role in economic progress, but that applies first and foremost to **private funding of research and development**. Increasing the public share of R&D financing will not bring proportionate results. The EU shouldn't engage in a numerical competition of the "share of public expenditure allocated to R&D".

Present Competitiveness Policy includes some programs that comply with the proposed principles and these programs, such as the **implementation of the pan-European transport and energy projects, should be included in the new budget[10].**

4. The CAP and Rural Development

Despite the diminishing relative significance of the Common Agricultural Policy (CAP), it continues to be the most resource-consuming and destructive of all EU policies (see the box below).

The agricultural sector under the CAP has become a purely social and political phenomenon, influenced by interest groups rather than the market. The price of evading the market is paid twice: once by taxpayers when their contributions directly finance agro-producers and again by consumers when they buy agro-products at a price higher than the market's, a price protected from external competition by EU-wide import duties. Due to the CAP, the EU has the world's most inefficient and expensive agricultural sector. Instead of gaining from the benefits of global competition and a division of labour, EU citizens inadvertently subsidizing consumption in non-European countries. The CAP does not contribute to establishing the conditions for prosperity of the EU as a global economic partner- enhanced business competitiveness and economic performance. The CAP is in all aspects unjustifiable: the member states have different problems, however the common policy applies the same mechanisms of subsidies to

[10] And that corresponds with the proposed Cohesion projects described above.

all states; the system itself is rigid and cannot respond to changing global conditions; it does not bring mutual benefits, yet leads to mutual problems and costs.

The CAP has undergone several reforms yet is now far from attaining the primary goals for which it was intended – to increase production, to stabilize the market, to create reasonable prices for agricultural products and to ensure a reasonable income level for producers. Generous funding caused overproduction and forced a modification of the payment system. Global demand for agricultural products and their consequent rise in prices may solve the producers' income problems. Furthermore, the financial support that was supposed to increase the income of agricultural producers as a rule goes to other market participants due to the visible and significant capitalization of that support - an increase in prices for agricultural land, agricultural vehicles, fertilizers and other goods purchased by agro-producers. The CAP also increases the demand for and the cost of unqualified labour, which slows the movement of workers from the less productive agricultural sector to more productive spheres. The most recent CAP reform reduced the level of intervention in the market, so market stabilization does not play a significant role anymore. The natural question arises "what does the EU want to achieve with its CAP nowadays?" Are there any visions and justifications why the agricultural sector has to be excluded and treated differently from any other business sectors? What is the mission of the CAP and why should it be carried on at the EU level given the radically different status and problems among the member states? There hardly are well grounded answers to these questions and the CAP is reduced to being either a political bargaining chip in negotiations or a mere tool for a region to become a net receiver of EU funding.

Some signs indicate that the discussion on CAP reform may take the dangerous form of "what should be financed instead of CAP?" Such a question is faulty in principle as it leaves out one more alternative - to reduce contributions. Even net recipients may be willing to support the abolition of the "first pillar" as a negotiation tactic to trade off for favourable votes in other policies.

The second pillar is rural development, a new form of agricultural policy designed to protect the environment and diversify the rural economy. Rural development may be becoming a trendy issue but it should be evaluated critically from the point of view of its effectiveness. A switch from CAP to financing rural development policies would mean 1) a greater overlap of agricultural and cohesion policies; 2) a larger market influence and an exhaustion of limited labour and time resources; 3) less transparent targets and fund distribution. Lavish financing of rural development would not be a better choice than current agricultural policy nor be the solution to current problems, just another bad policy that does not comply with the proposed tasks and principles of reform.

There is hardly any social or economic justification for the CAP and rural development programs. Attempting to create a "good" CAP is a waste of time and other limited resources. Given the deep-rooted tradition of financial support for the agricultural sector there would be a huge resistance to the abolition of all funding; thus **all efforts should be focused on the creation of a sound exit mechanism from the CAP**. One of the solutions could be an automatic reduction of the size of the budget together with gradually diminishing payments to agro-producers. **The Coalition proposes to reduce the contributions to the EU budget by the amount presently allocated to the CAP and rural development programs.** This redefinition of budget revenue and expenditure, especially of the CAP and Cohesion policy, would allow the EU to retain GNI as a revenue source and to reduce the contribution amount to 0.5 %.

Given that the competitiveness of the agricultural sector is hampered by the high compliance costs of EU quality and environment protection requirements, there is an **urgent need for deregulation of the agricultural sector.**

It needs to be stressed that the abolition of common agricultural policies does not mean agricultural funding should be shifted to the national level. **National support to the agricultural sector needs to be treated as state aid to any other sector of the economy is; thus, it must not be tolerated.**

Some may argue that the abolition of CAP funding would radically reduce or even eliminate the agricultural sector from the EU economy, since foreign agro-producers with more favourable climatic conditions can out-compete EU producers. These forecasts seem overly dire - there will always be a space in the EU's market for efficient and ecological production. Furthermore, the EU's agricultural sector amounts to only 2 per cent of EU GDP and only 5 per cent of the EU's population is engaged in agriculture. The fact that the EU is the second biggest agricultural exporter on Earth means that EU taxpayers subsidize global consumption - another argument in favour of abolishing the CAP.

5. Union's External Actions

'EU as a global actor' programs include development cooperation, humanitarian aid, European neighbourhood and partnership, common foreign and security policy and pre-accession measures.

The financing of Union's "external actions" has the fewest economic effects on the EU's economy and market behaviour because it is based on allocation, not redistribution, to targeted recipients outside of the EU. It is difficult to evaluate whether these expenditures have led to the achievement of the EU's goals; however, it is a priori apparent that allocating funds for the implementation of market reforms in non-EU countries would bring the highest value to the EU and the global economy. **The Union's external actions must be supplemented with the promotion of market reforms in non-EU countries and the liberalization of trade with these and other less developed countries.**

6. On European Public Goods

Economic theory does not offer an explicit definition or a precise list of public goods. In mainstream economics it is generally accepted that public goods are collective consumption goods characterized by two features: they are nonrival (which means that the consumption of the good does not reduce the amount of that good that is available for the consumption of others; for example, national defence) and non-excludable (the good may be consumed by everybody and it is difficult to prevent free riders from consuming it; for example, traffic lights). The private sector fails to provide these goods, at least at the present stage of technological or economic development. However, consumers desire these services and goods and therefore they must be supplied by a public provider or at least financed by public funds.

The concept of public goods in the European context has not been well defined. The EU's public goods are often understood as goals such as stability, growth, the common market, the preservation of resources, and competitiveness, rather than physical

phenomena. This is a misuse of the term since the attainment of certain goals does not require financial input, and vice versa, abstaining from proactive regulations or investment may help to achieve a number of goals. **European public goods and regular public goods should both denote solely material goods and services.**

7. On Climate Change Control and Mitigation

The issue of climate change is becoming the central issue for the EU globally. The established viewpoint is that climate change can be mitigated by financial tools and regulations. Although climate change does pose a certain economic threat, there are no sound economic reasons as to why the EU should be at the forefront of combating climate change at the expense of its citizens' welfare. Climate change is by definition a global challenge. The EU's attempts to combat it alone are both ineffective in results and counterproductive from the point of view of policy-making. Even if the world needs to be mobilized for this effort, it would be wise for the EU to wait until other countries have acknowledged the need to combat climate change rather than unilaterally promote this issue.

The argument that it makes economic sense to force EU citizens and business to take up "low carbon" practices early is only partially correct at best. While it might make sense to be the first to discover a certain technology, it also must be acknowledged that not every novel technology is feasible from the economic or even environmental point of view. The evolving situation with bio fuels may be an example of this. The "low carbon" technologies must be subjected to the forces of competition, not shielded from it.

It must be acknowledged that any sort of "climate change tax" on imported goods would have disastrous results on international trade. This kind of tax is already recognized as a protectionist measure by the EU's trade partners. Implementing such a tax would disrupt international trade and seriously impede further negotiations on the liberalization of trade.

The Coalition proposes to abstain from financing policies that are aimed at climate change control and mitigation.

8. On a European Value Added Tax

Despite the EU Commission's aspiration to make discussion on the EU budget without taboos, in its recent "formulaire contribution" one of the questions was "What criteria should be used to ensure that the principle of a European value added tax is applied effectively?" Thus there is already a notion that the principle of a European value added tax is a favoured one. As it was proposed earlier, the Coalition stands for a discussion with zero preconceptions regarding principles, size, revenue sources, policies, and measures. The principle of a European value added tax has not been adequately defined nor has a consensus on the essence and understanding of its application been reached. **The principle of a European value added tax needs more explanation before accepting it as a core budgeting principle**.

VI. The Size of the Budget

"What the government spends, the public spends less" Ludwig von Mises, "Human Action. A Treatise on Economics"

The Communication from the Commission states that „the EU budget is much misunderstood. It is at the same time large in absolute terms and small as a percentage of total EU public expenditure".

The relatively small size of the EU budget does not imply that the EU has a negligible influence on the European and global political and economical stages. Public financing is only one, and not the most important, tool in achieving public policy goals. The EU exercises significant regulatory impact on markets as well as upon social and political behaviour; hence EU regulations greatly increase the role of EU institutions. The compliance costs and their respective impact may be much larger in size than the EU budget. The EU's regulatory tools and costs should be considered together with the EU budget if one attempts to evaluate the EU's role.

The budget itself is a double-edge sword: it may bring funds to receivers and help to solve problems but at the same time it is always a burden to all contributors. If the budget fails to attain its goals then even a relatively small budget may face criticism. That is why it is crucial to ensure the effectiveness of the budget, both on revenue and expenditure sides, regardless of its size.

It is important that during the EU budget reform process the present size of the EU budget should not be considered as given and sacred. The task ahead is to find out whether the present level of redistribution is justified, not to redesign the allocation of billions of Euros per year.

Only a fundamental reform of the budget, not a reform of the budget's structure, may change Europe. The EU budget must be decreased if an agreement on common needs or attainable goals is not reached.

VII. Conclusions and Proposals

It has not been officially estimated how EU funds have contributed to the achievement of the aimed objectives. This should come as no surprise: the EU budget priorities have little to do with agreed EU priorities and challenges; the EU budget is manipulated to leverage the contributions and benefits of each member state. The current budget is a long way away from the original goals of the Common Market of the EU's foundation. We are in a hole, let's stop digging. The budget must be carefully re-examined from its roots in order to reach the benefit-maximizing outcome of the Budget's Prisoner's Dilemma. The preservation of the current EU budget system is too costly even given its relatively small size. Simply restructuring the budget in order to reduce funds allocated to the CAP would be too weak a measure to change Europe. "Reform the Budget, Change Europe" – this was the slogan that led to the budget discussion without taboos and raised hopes that change can happen.

The Coalition for a Free Europe urges that we RESTART THE EU BUDGET: "Ctrl+Alt+Del", that is to control spending, always think of alternatives, and delete all inefficiencies.

Therefore, the following steps must be undertaken:

On the reform process:

► The starting point for EU budget reform should be **zero preconceptions** regarding principles, size, revenue sources, policies and measures.

► To carry out a budget reform, not a reform of the budget's structure, to align aims with policies as well as policies among themselves, and thus - **to reduce the size of the EU budget if an agreement on common needs or attainable goals is not reached**.

► Policies and goals need to be realistic, achievable and consistent. **The financing structure must be in line with the priorities**. First and foremost, funding and spending principles must be agreed upon.

On revenue:

► To follow the principles of national contributions (democracy), fairness, simplicity, transparency and low administrative burden.

► To **eliminate VAT-based revenue stream**.

► To rely on member states contributions based on **equal proportions on GNI**;

► To reduce the financial role of traditional own resources, leaving them **as a temporary regulatory tool** and to move towards the deeper liberalization of trade.

► To **abstain from adding new sources of revenue**, that is any kind of "EU" tax. The introduction of such taxes should be banned.

► To **eliminate the corrections of payments or rebates**.

On expenditure:

► To follow the principles of subsidiarity and the efficient financing of goals, not interests.

► To direct all efforts to the creation of a **sound exit mechanism from the CAP** and rural development policies while annually reducing the contributions to the EU budget by the amount previously allocated to these policies.

► To redesign the cohesion policy, **focusing it on the removal of barriers to flexibility of markets and the free movement of factors of production inside the EU market and the improvement of infrastructure linking member states**.

► To **abstain from financing new highly uncertain goals**, such as climate change control, Galileo, etc.

► To **rely on the private financing of innovation**, research and development and not to increase present EU budget funding for these purposes.

► To supplement the Union's external actions with the **promotion of market reforms** in non-EU countries.

► To **avoid financing profit-seeking private companies** regardless of their region, economic activity or project.

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