European University Institute

EUROPEAN POLICY UNIT

In Collaboration With The

UNIVERSITY OF STRASBOURG and

TEPSA

E.U.I. WORKING PAPER No. 85/139

FINANCING EUROPEAN INTEGRATION

The European Communities and the Proposed European Union

by

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January 1985

This paper may be cited as forthcoming in:
Bieber, Jacqué, and Weiler(eds.), An Ever-Closer Union: A Critical Analysis of the Draft Treaty Establishing the European Union, in European Perspectives, Luxembourg.

Printed in Italy in January 1985
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Badia Fiesolana
50016 S. Domenico di Fiesole (FI)
Italy

The European Policy Unit

The European Policy Unit, at the European University Institute, was created to further three main goals. First, to continue the development of the European University Institute as a forum for critical discussion of key items on the Community agenda. Second, to enhance the documentation available to scholars of European affairs. Third, to sponsor individual research projects on topics of current interest to the European Communities. Both as in-depth background studies and as policy analyses in their own right, these projects should prove valuable to Community policy-making.

In October 1984, the EPU, in collaboration with the University of Strasbourg and TEPSA, organised a conference to examine in detail the Draft Treaty Establishing the European Union. This Working Paper, presented at the conference and revised in light of the discussion, will appear in book form later in 1985 along with other studies of the Draft Treaty.

Further information about the work of the European Policy Unit can be obtained from the Director, at the European University Institute in Florence.

November 1984

I. Introduction

Many people regard the Community budget and the present financial problems as being of a strictly fiscal or technical nature. They look upon the budget as a book-keeping exercise which has nothing to do with the structure and contents of the Community system. This is a wrong approach. Past experience, not only for the life span of the European Communities, but also the evolution of nation states, has given ample proof of the budget as a hinge in the historical process.

The American rebellion against British colonial rule was based upon a small fiscal question, but the political importance has never been forgotten. "No taxation without representation". The American rebellion was set in motion by a discontent of being taxed without having the right to determine the size of the taxation and for what purpose money was collected.

A large part of history concerning the establishment of the nineteenth century of the German Empire is a history of taxation. During that period of human history the main source of government revenue was customs duties. No wonder, then, that the first step towards unification of the German states was the Zollverein in 1830.

It is an indisputable fact that no state can be created without having access to revenue. Furthermore, the size of revenue will very often determine the scope of development of a new nation state.

On top of these economic and financial considerations comes the institutional and legal aspect of which institution has the powers to collect revenue and to determine the size and composition of the expenditure side of the budget.

Much of Europe's history is a tale of continuous struggle between king and parliament, about exactly that question. The king wanted to spend, but needed the consent of parliament to collect the necessary revenue. Parliament, on the other hand, did not want to spend and tried to limit the room of manoeuvre of the king with the unavoidable result that an institutional clash followed. On the surface the struggle was about money, but in reality it was about who governs the realm: the king or the parliament.

No wonder, then, that in recent years the budget has come to the forefront of Community life.

Financially, the substance and composition of the budget determine financial flows between citizens, regions and sectors in the Community, but above all between member states. There is general agreement that the financial flows which appear in the budget constitute only part - and some people think a very minor part - of the economic and financial consequences for the individual member state of the Community. However, this has not prevented these flows from being used in a highly political battle to change the structure of the budget.

At present, the Community's budget authority is made up of three institutions: Council, Parliament, Commission. The treaty was revised in 1970[1)] and 1975[2)] to increase Parliament's influence on the budget, generally in the area of the so-called non-obligatory spending.

This was regarded as a milestone ten years ago, but Parliament now takes the view that these increased powers are insignificant, indeed totally unsatisfactory.

Pending the possibilities for a further change in the treaty which has not until now found propitious ground in the Council, Parliament has continuously tried to expand its powers by interpreting the treaty to its own advantage every time the budgetary procedure has produced a difference of opinion between Council and Parliament.

Not surprisingly this has led to a constant battle between Council and Parliament during the annual budget procedure with Parliament in the attacking role and

Council as the defender. There is no need to go over that familiar ground. Suffice it to say that Parliament has won certain limited victories, but grosso modo the distribution of powers is still as foreseen when Budget Treaty II was implemented in 1975.

Since 1977, only two budgets (the 1978 budget and the 1983 budget) have been approved without any disagreement of legal or political nature between Council and Parliament. Parliament has rejected one budget (the 1980 budget). Council took Parliament to court on the 1982 budget, but did not pursue the matter as a settlement was made. Three countries took Parliament to court on the 1981 budget, but did not pursue the matter. For the 1979 budget and 1984 budget there was disagreement between the two institutions on whether the amount of non-obligatory spending complied with the rules laid down by the maximum rate of increase or whether a new rate had to be fixed by mutual agreement.

Some people maintain that the reason for Parliament's attitude towards the budget is that Parliament has no powers with regard to the Community's legislative process which makes it unavoidable that Parliament directs its efforts towards the one area where the treaty provides powers, that is the budget.

This theory may provide part of the answer but to our mind the main reason is quite simply that Parliament has grasped that the road to influence on Community life and the structure of the Community system is by way of the budget.

This leads to the starting point of this report, which is that the budget and the distribution of budgetary powers on the three institutions are of fundamental importance for the structure of the Community system and the way the Community will tend to develop for the rest of this century.

We are not dealing with technical questions which are only open for experts but with a political question of the highest importance for the future evolution of the European Community.

II. The present Community budget

1. Size of the budget

The Community budget is small compared with national budgets as well as gross domestic product in the Community.

Since 1973 the Community budget has amounted to between 1.8% and 2.7% of national budgets.

At the lower end of the range we find 1975 with 1.8% and at the top we have 1979 and 1980 with 2.7%.

Compared with gross domestic product the percentage has fluctuated between 0.51% (in 1974) and 0.91% (in 1981).

There is no need to elaborate on the fact that we are operating with very small figures which have a very limited impact on national economies and play a minor role in the integration process.

The main reason why the Community budget has not grown faster is that except for the common agricultural policy, common policies are still of an embryonic nature.

The hard fact is that the member states have not been willing to design and adopt common policies giving rise to expenditure over a broad level, but have been quite content to confine the activities of the Community to the common agricultural policy. This seems often to be overlooked in the debate on the Community's structure.

2. Expenditure

This picture is borne out by an analysis of the expenditure side of the budget.

It is dominated by the common agricultural policy which in the period from 1973 to 1984 has taken up between 60% and 80% of total expenditure.

Both the absolute amounts and the share of the total budget have fluctuated rather wildly over the years. The highest share was realized in 1973, but 1978 comes close. The lowest point was obtained in the beginning of the 1980s when the world conjuncture was favourable

This revenue source cannot claim the same link to the contents of the Community system as is the case for customs duties and agricultural import levies. There are two reasons why the Community introduced the VAT as a financial source. Firstly, it fitted in nicely with the efforts to harmonize the basis of indirect taxation in the Community. Secondly, VAT taxes consumption and not investment.

It is interesting to note that the inclusion of VAT means a certain progressivity in the financing of the Community as consumption per head is higher in the richer member states than in the poorer ones.

Even if this was not an explicit purpose it goes some way to meet the claims of progressivity on the revenue side of the budget, which have been made by some member states in recent years.

Table 2 presents the total financial resources at the disposal of the Community in the period 1973 to 1984 and the importance of the main revenue sources.

The table bears out that the agricultural import levies are volatile while the customs duties cannot be expected to increase significantly. Thus the only buoyant element is VAT.

4. Significant elements in the Community's financing system

Viewed in a historical perspective, the financing system of the Community is unique in several aspects.

First of all, member states are legally committed to pay into the budget what is necessary to finance the common activities adopted by the Council (provided of course that the revenue needed does not surpass the VAT ceiling). This means in fact that the financing of the Community is not dependent on national contributions voted by national parliaments. A refusal by a member state to pay according to the rules of the own-resources system would constitute a breach of an international treaty and there would be no doubt how the Court of

Justice would rule in such a case. The Community does not work under the threat of individual member states withholding financial resources unless they are accommodated in one way or another. The contrast to the financing of traditional international institutions is very clear, indeed.

Secondly, the financing of the Community is not linked to the economic clout of the member states, for example gross domestic product, but reflects the two corner-stones of the Community, that is the customs union and the common agricultural policy. Also in this respect the Community breaks with the financing system of traditional international institutions.

These two factors are the basis for the own resources system which is one of the most significant elements of the Community structure. The first factor means that the Community has access to financial resources from the time they are collected in member states. This is why they are own resources. The second factor underlines that we are dealing with a Community with ten member states and not a loose international cooperation encompassing ten national states.

III. The Community's budgetary procedure

1. Different types of appropriations

The treaty distinguishes between obligatory and non-obligatory spending.

Obligatory spending is expenditure which necessarily results from the treaty or from acts adopted in accordance therewith.

Typical examples are appropriations for FEOGA and agreements with third countries.

Non-obligatory spending is expenditure which does not necessarily result from the treaty or from acts adopted in accordance therewith.

Typical examples are appropriations for the Regional and Social Funds.

The distinction between the two types of spending is of paramount importance for the budgetary procedure and the distribution of powers among the three institutions which constitute the budget authority.

The Commission has the right of initiative in this as in other areas.

The Council has the final decision with regard to the size and composition of obligatory expenditure. This is logical. It is the Council which adopts the legal acts which constitute the basis for expenditure. Accordingly, it must be up to the Council to decide the amount necessary to carry out the obligations which follow from these legal acts. It is in accordance with the fact that Parliament does not have any legislative power that the powers of Parliament concerning obligatory spending are very limited.

Had Parliament been given powers with regard to obligatory spending, it would have been possible for Parliament to obtain legislative powers via the budgetary system. By reducing or increasing obligatory spending Parliament would have forced the Council either to change the legal acts or to face a situation where the Community could not fulfil its legal commitments.

This is a case in point that the Community system with regard to distribution of powers among institutions as well as the structure of the common policies and their financing is far more coherent and well thought out than most people think when they first meet the very complicated Community system.

With Budget Treaty II of 1975 Parliament got influence on the size and composition of non-obligatory spending.

Parliament has the final word with regard to size as well as composition, provided that the rules for application of the maximum rate of increase are respected.

As non-obligatory spending does not result from the treaty or legal acts it is up to the Community institutions to fix the amount for the common activities according to political priority. There are no legally binding commitments. The exclusive power of the Council in the legislative process does not prevent Parliament from influencing the size of appropriations for headings in the budget which are classified as non-obligatory spending.

There is a gap in the treaty in the sense that it does not specify which appropriations are obligatory and which are non-obligatory.

For a good many years this question was not raised during the annual budgetary procedure. The existing classification was taken for granted by all three institutions.

This peaceful situation was broken in the autumn of 1981 when Parliament unilaterally changed the classification of some items in the budget and unilaterally decided to classify certain new items as non-obligatory spending.

This was a matter of principle for the Council and as a political solution was not reached the Council took Parliament to the Court of Justice.

During the spring of 1982 a political settlement was worked out which was signed June 30 1982 by the Presidents of the three institutions. This common declaration contained several new elements but the most important one for the classification question is that it lists the disputed items and maps out a procedure to be followed in case of disagreement in the future.

The common declaration did not prevent Parliament from unilaterally breaking the agreement with the Council in the second half of 1983 concerning the classification of amounts to be paid out to Britain.

Parliament has for a long time wished to change the treaty, exactly on the point of distinction between obligatory and non-obligatory spending. This is, indeed, one of the major points of the draft treaty establishing the European Union, which we will take up later.

2. Existing powers of the three institutions

According to the treaty there is a clear-cut distribution of powers among the three institutions which constitute the budget authority.

The Commission forwards a preliminary draft budget and takes part in the Council's deliberations and the meetings in Parliament and Parliament's budgetary committee. The role of the Commission in the budgetary procedure is thus very much like the Commission's general role as the initiator and the guardian of the treaty.

The Council decides on the draft budget which is forwarded to Parliament. Legally this takes the form of a Council decision. It is the Council which has the final word with regard to obligatory spending while the fixing of non-obligatory spending partly falls under the competence of Parliament.

It is the President of Parliament who declares that the budget has been finally adopted.

If important reasons warrant it, Parliament may reject the draft budget and request that a new draft be submitted to it.

Furthermore, Parliament has the final word with regard to the composition of non-obligatory spending.

The treaty implicates a sort of ping-pong between Council and Parliament. Council forwards a draft budget before a deadline. Parliament makes amendments (non-obligatory spending) and proposes modifications (obligatory spending) within 45 days and it is up to the Council to act on these proposals. When Council has decided on the proposed modifications the budgetary procedure for obligatory spending has been completed. With regard to amendments the Council's decisions are communicated to Parliament which completes the budgetary procedure by finally deciding on non-obligatory spending at its December session.

By and large, this procedure has served the Community well and is a good example of how to distribute powers among various institutions with the aim of establishing an interplay leading up to a final decision backed by the consent of all involved.

This, however, supposes that all the institutions play by the rules. There are two snags in this assumption.

Firstly, the rules do not always cover the whole spectrum of possible problems, and even if they do the institutions do not always reach the same interpretation.

A typical example of this is that the treaty contains only a general classification of obligatory versus non-obligatory spending.

If and when a difference of opinions arises, it places the institutions in the dilemma of either having to negotiate a common interpretation of the said question or to take the matter to the Court of Justice, on the allegation that one of the institutions has acted illegally.

Experience shows that Parliament has found it quite attractive to try to find out just how far it can go before the Council finds that a major shift in powers is taking place.

This is a highly political game with the Council trying to defend its prerogatives without really knowing where to put down its foot and how firmly to defend its position.

Since 1975 Parliament has definitely gained much greater influence on the budgetary procedure by gradually pushing the interpretation of the treaty in the direction wished by Parliament. The aim has generally been to make room for a steeper increase in non-obligatory spending than Council has voted.

Secondly, the budgetary procedure, as laid down in the treaty, is of legal nature.

It does not preclude that the institutions circumvent the treaty and fix an important part of the budget by a mutual agreement.

Such a procedure means that political considerations replace the strictly legal procedure. As long as all three institutions are agreed that this can be done, it is possible to do it that way. Who shall take the matter to the Court of Justice with the allegation that one of the other institutions has acted illegally if there is political agreement between the three institutions?

It is in this respect that recent years have shown the biggest slide in the budgetary procedure compared with the strict rules in the treaty.

The first and most spectacular example is what has happened to the maximum rate of increase. The treaty clearly specifies how to apply a complex set of rules to respect this rate but adds that another rate may be fixed by agreement between Council and Parliament.

Reading the treaty no one can have any doubt that the possibility of fixing another rate is some sort of escape clause to be used when special circumstances make it appropriate. Otherwise, there would be no reason for having the complex set of rules when this special paragraph could be replaced by one sentence saying that the size of non-obligatory spending is fixed by Council and Parliament by agreement.

This interpretation notwithstanding, Parliament has forced a level of non-obligatory spending which surpasses the maximum rate of increase for practically all Community budgets since the late 1970s.

The driving force behind this has been the demand put forward by Parliament that there is a political need in the Community for a higher level of spending. This may be right or wrong but it underlines the point that gradually the procedure in the treaty is being replaced by political considerations.

This became crystal clear in the second half of 1983 when the draft budget for 1984 was being discussed. Parliament unilaterally rejected an earlier agreement between Council and Parliament concerning classification of the amounts to be paid out to Britain. Furthermore, Parliament put forward, not as a suggestion but as a claim, that agricultural spending should be reduced by a considerable amount.

What was alarming about this claim was not that it was made but that it was not made according to the rules of the treaty. According to the treaty Parliament should have put forward a modification to reduce agricultural spending. This modification would have been approved unless rejected by Council by a qualified majority. After the Council decision during the Council's second reading in the middle of November 1983 the budgetary procedure for agricultural expenditure would have been finished as at this point we are dealing with obligatory expenditure.

Instead, Parliament put forward its claim at a special meeting between Council and Parliament, called during Parliament's final session in the middle of December 1983. Parliament did recognize that the budgetary procedure for agricultural spending had been finished but supported its claim by pleading the important political considerations.

Fortunately, for the respect of the treaty, Council did not budge but chose in this case to stand firm and tell Parliament that its claim could not be met as the budgetary procedure for agricultural spending had been completed a month ago.

3. Conclusion

The danger of the present budgetary procedure is not that there are certain gaps where different interpretations can be put forward but that one institution, Parliament, is fundamentally dissatisfied with the whole structure of the budgetary procedure.

Parliament is of the opinion that the strict budgetary procedure, as laid down in the treaty, should be replaced by a continuous, political negotiation from start to end of the budgetary procedure.

As it is the President of Parliament who declares the budget finally adopted it gives Parliament the upper hand in the sense that unless Parliament is satisfied a legally adopted budget will not be available from the beginning of the budget year.

The Council has resisted this attempt not only because it would greatly increase Parliament's influence on the budget but also because Council cannot renounce - not even implicitly - the treaty. It would create a precedent in other areas.

It is open to interpretation which line the newly elected Parliament will follow but most indications are that it will continue the road taken by the former Parliament.

If that happens Council will in a few years, perhaps sooner, come to a crossroads where it must make the political decision between either facing up to Parliament and maintain its prerogatives as laid down in the treaty or giving in to Parliament and accept a fundamental change in the distribution of powers concerning the budgetary procedure.

IV. The Community's present budgetary problems

1. Own resources

It became clear at the end of the 1970s that the own resources, as defined in the decision of April 1970, would not be sufficient to finance the Community in the future.

Continuation of present policies would not be possible as customs duties and agricultural import levies would tend to level off, leaving the VAT revenue as the only buoyant element. It is a well-known fact that the expenditure level for the common agricultural policy is highly volatile and a steep increase for a year or two would threaten to break through the VAT ceiling.

It would be even more difficult to launch and implement new common policies. At the beginning of the 1980s an increase of the VAT revenue for the Community of 0.1 percentage point puts approximately 1,000 million ECU at the disposal of the Community. This is peanuts compared to what would be necessary for a broad range of new common policies.

In political terms, it was perhaps more important that the enlargement with Spain and Portugal would be impossible unless the financial resources at the disposal of the Community were increased. If the VAT ceiling was maintained it would mean that Spain and Portugal were to join quite another Community than the one they had wanted to be members of. Such a political venture was simply not feasible.

For 1982 the own resources were fully exhausted.

For 1983 the Community actually used more than was at its disposal under the own-resources system. The call-up per cent of VAT was fixed at 0.99, but expenditures, equal to 675 million ECU under the common agricultural policy were carried over to 1984.

For 1984 the Commission estimates a shortfall revenue amounting to approximately 2,000 million ECU. The Commission has asked for this amount to be placed at the disposal of the Community by advanced payments of VAT revenue from the member states.

For 1985 the preliminary draft budget of the Commission envisages a shortfall of approximately 1,900 million ECU.

The Commission intends to solve this problem by letting the increase of the VAT ceiling to 1.4% take effect from October 1 1985 which will make it possible to operate with a call-up per cent of VAT for the whole of 1985 of 1.12%.

It took several years and was very difficult to agree on an increase of the VAT ceiling from 1% to 1.4%.

This must not obscure the fact that this increase will hardly be sufficient to tide the Community over until the end of the 1980s.

If we start on the assumption that the preliminary draft for 1985 is based on correct data the Community will sail into the new era of increased VAT resources with a VAT per cent of 1.12. Add to this an estimate of 0.2% which will be needed to finance the enlargement and the astonishing fact is that a new and further increase will impose itself. The European Council has partly foreseen this which is why a further increase to 1.6 taking effect in 1988 is mentioned as a possibility.

The unavoidable and disheartening conclusion is that the Community may be able to finance itself until 1990 on the basis of a VAT per cent of 1.4 or 1.6 but only on the condition that the structure of the common activities is frozen in its present shape.

We will thus six years from now see a Community with one predominant common policy giving rise to expenditure, namely the common agricultural policy, and the balance of the financial resources used mainly to finance the enlargement.

No new common policies giving rise to expenditure will have been launched and implemented and the Community system will be just as unbalanced as it has been for the last five-ten years.

It is remarkable that this has not really been understood when the financial problems were negotiated. Only a few countries supported a VAT increase to between 1.5 and 2%. Most member states were quite happy that the VAT increase was limited to 1.4%. Among them were Britain and the Federal Republic of Germany which have for years advocated a better balance between the Community's common policies but when the Community came to the crossroads they were not willing to place the financial resources necessary to implement such a policy at the disposal of the Community.

2. Budgetary discipline

A new concept has been born during the recent negotiations on the Community's future financing: budgetary discipline.

Until the meeting of the European Council in June 1983 budgetary discipline was a concept which was hardly known in Community circles, but after that juncture it has risen in importance with every meeting of the European Council.

The main idea of budgetary discipline is to define a financial framework for total Community expenditure. Before each budgetary year it is decided how much total expenditure is allowed to increase and the budget must be drawn up with respect of that ceiling.

During the first half of 1984 this approach was further refined in the sense that a separate ceiling for agricultural expenditure and for non-obligatory expenditure was worked out.

For agricultural expenditure the idea is that the annual increase shall be lower than the growth rate of the own resources. Both figures are to be calculated on a base covering three years.

Furthermore, account has to be taken of special circumstances, in particular following from the enlargement. This phrase means that the general rule is not to be applied in a strict sense but may be abrogated if and when it is deemed necessary.

It was primarily Britain, supported by the Netherlands and the Federal Republic of Germany, which managed to get approval of this idea.

For non-obligatory spending agreement was reached that the maximum rate of increase should not be surpassed for the coming budgets. To respect this aim the member states took it upon themselves to decide on a draft budget inside half of the maximum rate which leaves the other half at the disposal of Parliament.

It is not difficult to see the political aim of budgetary discipline but it is, indeed, a strange animal in the Community zoo. It is without any foundation in the treaty or the acquis communautaire.

Firstly, it is doubtful, to put it mildly, whether budgetary discipline as agreed upon by the Council is in conformity with the treaty. It may be said that the Council is free to impose upon itself any sort of discipline but this can hardly be right when the rules infringe the powers of other institutions or runs contradictory to the treaty.

The idea of fixing a framework for total expenditure before the budgetary procedure is not foreseen in the treaty and may, indeed, be said to limit the Commission's right of initiative. What is left of this right if the Council has announced beforehand that whatever the Commission puts forward and whichever arguments are used to support it, the Council has already decided what to do?

The interplay between the institutions is more or less violated in the sense that the Council has decided not to use the last paragraph of Article 203, 9, which foresees the possibility of fixing a new and higher maximum rate of increase. What is the purpose of having this paragraph in the treaty if one of the institutions decides that it cannot be used? Parliament can rightly say that the finely-tuned budgetary procedure has unilaterally been set aside by the Council in the sense that the end result with regard to total expenditure as well as its distribution on obligatory and non-obligatory appropriations has been decided in advance by the Council.

The ceiling for agricultural expenditure may be said to question the contents of what is called obligatory expenditure. Hitherto, obligatory expenditure has been fixed at the amount which followed automatically from legal acts adopted by the council. The amount of obligatory expenditure was, as it were, determined by the contents of the legal acts and not to be fixed at an arbitrary level by the Council."

If the ceiling is to be respected the Council has only two possibilities. The first one is to make arbitrary cuts in agricultural spending so that the budgetary ceiling replaces the legal acts as the decisive vehicle for the size of agricultural spending. This would mean that the concept of obligatory spending was de facto removed from the vocabulary of the Community. The second one is to tell the Agricultural Ministers that they must shape a common agricultural policy for which expenditure does not surpass the ceiling. This is, of course, feasible, at least in theory, but it means that the policy-making of the Community is moved from one Council (agriculture) to another (budget). Furthermore, an interesting clash would occur in case the Agricultural Ministers are not inclined to follow the directives imposed upon them by the European Council and implemented by the Budget Ministers.

The decision not to surpass the maximum rate of increase is of course perfectly legal, but it is questionable whether it remains so if the other branch of the budget authority - Parliament - does not agree.

Under this rule non-obligatory spending would grow at a very modest rate, indeed, measured in real terms. It is very difficult to see how the Community could take up new common policies if the growth rate of expenditure for this purpose is limited to 7 or 8%. The consequence of this policy is thus that the Community is frozen in its present shape with the inevitable result that all problems associated with the Community's future financing will still be there at the end of the 1980s.

It is often said that as member states are taking a very rigorous attitude towards the expenditure side of national budgets the same should be the case where the Community budget is concerned.

This attitude which is comprehensible is based on a wrong philosophy concerning the role of the Community and the division of responsibility between, on the one hand, the nation state and, on the other hand, the Community.

The European nation states have in the past implemented common policies over a broad range. It is only natural that these policies are being scrutinized and that expenditure often is being trimmed. From time to time existing policies have to be adapted to new circumstances and at present nearly all member states face the unpleasant fact that public expenditure has out-grown what the economic base can sustain.

But this is not the case for the Community. The Community has only one common policy which gives rise to expenditure, namely the common agricultural policy. For this policy exactly the same scrutiny as the one applied by the nation state has been carried out to make savings. A lot of measures have been adopted to this effect.

In all other areas no common policies worthy of this word have been implemented. A restrictive line towards expenditure means that no common policies are being shaped. It means that the distribution of responsibility between the nation state and the Community is being left to its present status.

It is, indeed, strange that no serious attempt has been made to allocate certain tasks to the Community and abandon the same tasks at a national level. Such a procedure would mean that the responsibility and expenditure would be transferred from national level to Community level. Total expenditure in Europe would not rise because national expenditure would go down and Community expenditure would accordingly go up. If policies are picked with an eye to what is suited for international cooperation it may even be cheaper for everybody concerned to let the Community do the job instead of having ten individual nation states trying to do it at the same time!

The much heralded concept of budgetary discipline may well turn out to be a snake in the Community paradise. Institutionally, it may trigger off a major confrontation between the different branches of the budget authority. Legally, it is doubtful whether it is in conformity with the treaty. It may jeopardize the common agricultural policy and at the same time bar the way for new and other common policies.

3. Budgetary imbalance

The most difficult point during the accession negotiations in 1970 and 1971 was the British contribution to the Community budget. When this problem was solved it was clear that the negotiations would be successfully concluded.

British calculations at that time pointed towards a financial burden for Britain, but it was rightly stressed by the other member states that the calculations were based upon the assumption of a static Community. If Britain took the lead in developing the Community outside the agricultural sphere it would change the pattern of financial flows between member states.

It is interesting to note that the British criticism has not been static but has developed over the years.

It started as a dissatisfaction with the receipts side of the budget, that is the own-resources system. The British Government took the view that as Britain's share of imports from non-member countries was above the Community average Britain would pay in customs duties and agricultural import levies in excess of what a GDP key would have led to. Apparently it did not make any difference that this is exactly how the own-resources system is supposed to work because of the Community preference.

This approach led to the adoption of the corrective mechanism[4)] which was agreed in principle at the European Council meeting in Dublin in 1975.

A few years later the British Government evoked once more the budgetary problem but now it was presented in the sense that the so-called British net contribution was grossly out of line with Britain's relative standard of living.

In conceptual terms, this change of approach signified that from focusing on the receipts side only the British Government now also brought the expenditure side into the picture.

For the last five years the concept of net contribution has dominated the Community's agenda and played a major role in the Community's life.

This is regrettable - for several reasons.

Firstly, the British net contribution amounts to between 0.3% and 0.4% of the UK's gross domestic product.

The Community as such has paid a heavy price for trying to solve a problem which cannot be said to be of importance either for the Community itself or for Britain. This goes without saying that the whole basis of calculation of the net contribution is subject to criticism[5)].

Secondly, nothing in the treaty or the acquis communautaire warrants the concept of net contribution.

On the receipts side the own-resources system lays down that the geographical place for collecting revenue is of no importance and that there should be no link between what is paid in from a member state and its share of Community GDP. In fact, it can be said that there is no such thing as member states' payments to the Community budget because what member states pay in belongs to the Community as such and the member state is only acting as a collector.

On the expenditure side we distinguish between two types of appropriations in the budget. The common agricultural policy is based upon the principle that the geographical place for payments is irrelevant. It should amount to the same for the individual farmer whether he receives restitutions, sells to intervention or sells his products on the market. Thus the fact that a farmer in one country receives restitutions makes it possible for a farmer in another country to sell on the market at the going price. This is why we speak of a common policy and not of ten individual policies which are coordinated. For the structural funds exactly the opposite applies. Here we have, at least implicitly, a geographical key to ensure that the Community assists less developed regions in their endeavours to obtain economic growth.

This analysis shows why it makes no sense to operate with the concept of net contribution. The receipts side of the budget and the expenditure following from the common agricultural policy explicitly reject a geographical key . For the structural funds a geographical key has already been implemented.

The concept of net contribution is thus a mixture of receipts and payments - mutually incompatible - based on a philosophy which is in contradiction to the very principles of the Community system[6)].

Parliament has adopted a line which has very much in common with the above analysis which has also been the case, at least partly and in softer terms, for nearly all other member states except Great Britain.

In the second half of 1983 and the beginning of 1984 an attempt was made to solve the British budget problem by focusing exclusively on the payment side of the Community budget.

The philosophy behind this approach was that the British budget problem had arisen because of the imbalance between common policies and the resulting financial flows between member states. A glance at the expenditure to member states measured in per cent of their GDP shows that Britain receives a share far below the Community average. (For 1982 total expenditure amounted to 0.75% of Community GDP while payments to Britain amounted to 0.49% of the British GDP). If the imbalance were corrected it would mean that the British share would approach the Community average and there would be no British budget problem. In the meantime the Community should take upon itself to alleviate the British problem by partly compensating the expenditure shortfall[7).]

At the European Council meeting at Fontainebleau a mechanism was approved which does not totally follow this philosophy but at least has certain resemblances.

However, the fact that the Community at the same time decided to implement a bugetary discipline will mean that in four or five years' time the present imbalance between common policies will still exist and the British budget problem will return to the negotiating table.

The weak chain in the armour is that the Community did not decide to establish new common policies and to regard the mechanism to solve the British problem as a transitional mechanism. Instead, it must be feared that the mechanism is here to stay and that new common policies will never be permitted to take off.

4. Different philosophies towards the Community's financing

What to the general public appears as a budgetary or financial question is thus a question of which philosophy to apply for the future development of the Community. The main battle is about approach and not about money. Even if the two things in the long run are intertwined.

One approach - the pure one - gives full priority to the contents of the Community system, that is the common policies, and the budget is allocated a role very much in the background. What matters are the legal acts and the substantial decisions taken by the Council. The budget is merely a book-keeping account which reflects these decisions but does not have any impact on policy.

If expenditure is rising too fast or if a budgetary imbalance arises the problem is not a budgetary or financial one, but a question of whether or not the

Community system works as intended. The budget is the instrument which sets off the alarm but any correction has to be taken via a change or an adaption of the existing legal acts. The budget has no role in policy-making.

The own resources should be expanded considerably. The increase of the VAT ceiling to 1.4% and possibly a further increase to 1.6% is regarded as totally insufficient. There must be enough financial manoeuvring room to permit the development of new common policies while at the same time the existing common policies are continued grosso modo in their present shape.

The role of the own-resources system is to provide financing of the common policies adopted by the Council. In principle, no financial ceiling should be applied as this will implicitly act as a brake on efforts to further the integration process.

Budgetary discipline as worked out during the first half of 1984 is some sort of anathema to this approach. For obligatory spending expenditure follows what is necessary to implement the common policies. For non-obligatory spending, appropriations necessary to launch and implement new common policies should be approved. This does not mean that the Community should spend without taking into account the harsher financial climate but that a financial straitjacket is totally out of order.

An analogy to national policies is rejected on the basis that a Community in an embryonic phase must necessarily face a rapid increase in spending as common policies are gradually accelerating.

The concept of net contribution does not belong in this context. The own-resources system works as designed and the expenditure side of the budget may be changed if there is a need for it but, if so, it must be done by way of the common policies and not by intervention in the budget itself.

The other approach - the budgetary one - is looking at the Community system from the opposite side of the spectrum.

The budget must work inside a rigorous financial framework and produce equitable financial results for each member state. If something is wrong with the budget it should be remedied at once by direct changes in the budgetary and financial mechanisms. If such steps are incompatible with the existing common policies and the legal acts adopted by the Council, these have to be changed to produce the necessary budgetary and financial results. First priority is thus given to the budget and all the rest has to follow as best it can. It does not really matter what we do or what we do not do in conformity or not with the Community system as long as the budgetary results are satisfactory.

The analytic base for the Community system and its budget is approximately the same as for a grocer's shop.

Expenditure must not exceed revenue and if it does happen expenditure has to be cut to fit the revenue available.

A higher VAT ceiling can only be contemplated when a rigorous savings policy has not brought down expenditure to the level of revenue.

Budgetary discipline has been consecrated in this approach. If only the Community can bring its expenditure into line all will be well. It does not matter that the common agricultural policy is jeopardized and that the integration process is being brought to an abrupt stop.

In this approach there is a strict analogy to the nation state. When the individual member state has to save the Community must also save. The effect of this, namely that an existing national policy is being trimmed while the common policy of the Community is being killed before it even gets off the ground is not being discussed.

Budgetary imbalance is another key word in this approach. The budget must show an equitable burden sharing (the word profit sharing is far better as the

Community is producing a surplus but is, however, not used). Failing that, the budgetary system including the own-resources system should be changed. This should not be done by adapting the common policies to bring about a better balance but by way of direct changes in the budgetary system as such.

This underlines the difference in conceptual terms between those who on the one hand have talked about a better balance between common policies and those who have used the term a better budgetary balance. This may sound as a question of semantics but is not at all so. It is a question of how you approach the very principles of the Community system and which role to assign to the budget.

Until 1980 the first approach (the pure approach) was the only one in the Community. There was no talk about budgetary discipline or budgetary imbalance and the concept of net contribution was never heard of.

The founding fathers of the Community had with great skill drawn up a Community which was logic in the sense that the substantial decisions taken by the Council were the determining factor and the budget did not play any role as such in policy-making.

The reason for this is not difficult to comprehend. It was the only way to further the integration process where new common policies could continuously be launched and implemented.

In this conceptual framework the driving force is new decisions and the financing is being provided by the member states without questioning the growth rate of expenditure or the financial result for each individual member state.

The founding fathers realized that a Community where the financial aspect is predominant would stop the integration process. Member states would try to save money (either to reduce total spending or to use the amount at national level) and member states would only support the common policy if the difference between receipts and payments was positive.

This prediction of what one or the other of the two approaches would mean for the European integration process has indeed been borne out by experience during the last five - ten years.

Around 1980 the picture changed in the sense that the pure approach was no longer the only approach. One member state, with more or less firm support from one or two other member states, introduced the budgetary approach.

The heart of the matter of the negotiations on the Community's future financing for the last five years has been whether the pure approach should continue to be the predominant one or whether it should be replaced by the budgetary approach.

This has been difficult to realise because tangible factors such as financial flows and money have been in the forefront of the picture. However, digging a little deeper we see clearly that the money question has only been a skirmish while the main battle concerning the conceptual basis for the Community has raged in the background.

The solution reached by the European Council at Fontainebleau in June 1984 may be said to safeguard the essential elements of the pure approach while at the same time it accommodates important elements of the budgetary approach. It is thus a political compromise and as such it will undoubtedly place the Community in a difficult situation when necessary decisions are to be taken in the years ahead.

The battle has not been won by any party but a ceasefire has been concluded in the hope that the problems will diminish as the Community develops further. That is a pious hope and it remains to be seen whether it will be fulfilled.

5. The position of the European Parliament

The European Parliament has for many years supported the European integration process. Indeed, it can be said that up to the mid-1970s Parliament put forward many ideas for new common policies. After that period, however, Parliament's attention has gradually focused more on institutional questions than on the contents of the Community system. Parliament has devoted more and more time to obtain increased powers and more influence on the decision-making procedure with the inevitable result that less time has been available for dealing with the common policies.

With regard to the budgetary question Parliament has always defended what we termed the pure approach in the analysis under point 3 above.

Not only has Parliament been a steadfast supporter of the Community system but it has maintained its procedure concerning the budgetary system and its role even in a period where several member states have been willing to consider important changes.

On many occasions Parliament has pointed out the pitfalls and weaknesses in the special arrangements agreed in the Council as temporary solutions to the British budget problem. Parliament has called for a permanent solution in conformity with the principles of the Community system and within the framework of the existing own-resources system.

With regard to own resources Parliament has taken the view that the existing one per cent VAT ceiling is totally insufficient to finance the Community. Parliament has asked for abandonment of the ceiling or at least introduction of a more flexible procedure to lift the ceiling if and when the need arises.

Parliament has been heavily criticized for being a spendthrift and it is correct to say that the word budgetary discipline does not play a predominant role in Parliament's vocabulary. This is, however, not surprising in view of Parliament's general philosophy regarding the Community system. Parliament's position is also more nuanced. Parliament has tried to impose savings in the common agricultural policy on the

Council, without much success. Nor has the attempt to increase non-obligatory spending been successful as the Council has not provided the necessary legal basis for new common policies.

The British budget problem or rather the term budgetary imbalance has been regarded by Parliament as a result of the imbalance in the Community system and not as a strictly budgetary or financial problem.

Parliament's views on the philosophy behind the Community system and the role of the budgetary system are thus logical and correspond closely to the approach which dominated the Community scene until 1980.

Parliament is the only institution which has been able to define and maintain a coherent view on the problem of the future financing of the Community. The Council has been under constant pressure from one member state with more or less support from a few others. The Commission has found it difficult to map out the narrow road between Scylla and Charybdis. On the one hand the Commission has by instinct defended the pure approach. On the other hand the pressure for a political solution has pushed the Commission towards the budgetary approach.

V. Summary of part five - the finances of the Union (Articles 70 - 81)

Article 70 contains the general aims and provisions.

Article 71 concerns the revenue. The Union inherits the revenue system of the European Communities. This means that in the starting phase VAT will be the main revenue source. However, the Union may by an organic law create new and other revenue sources. Contrary to the present procedure such a step does not require ratification in member states.

Article 72 deals with expenditure and lays down that expenditure shall finance the common policies adopted by the Union.

Article 73 proposes a system for financial equalization to alleviate excessive economic imbalance between the regions.

Article 74 puts forward a proposal to divide responsibility between the nation states and the Community. It also contains a provision for multi-annual financial programmes which will provide the framework for revenue and expenditure in the years ahead.

Article 75 confirms that the budget must be in balance. It also defines the role of lending and borrowing.

Article 76 defines the budgetary procedure which will be even more complicated than the already existing rules in Article 203 of the treaty.

Article 77 deals with provisional twelfths in case the budget has not been approved at the beginning of the financial year.

Article 78 says that the budget is implemented by the Commission.

Article 79 deals with audit of the accounts.

Article 80 and Article 81 concern the account and discharge of the annual budget.

VI. The main features of Parliament's proposal

1. General philosophy

The starting point for the analysis of the provisions concerning the finances of the Union (Articles 70 - 81) is that Parliament does not wish to change the role of the budgetary system in the integration process.

Adoption of Parliament's proposal would mean that the budgetary system would play the same role as was assigned to the budgetary system in the treaty of Rome and the acquis communautaire which developed in the period 1958-1980.

It is the legal acts adopted by the Union which determine the size of the expenditure and member states are committed to put the necessary financial resources at the disposal of the Union.

It is explicitly said that the revenue of the Union shall be utilized to guarantee the implementation of common actions undertaken by the Union.

Parliament turns the blind eye to recent ideas concerning budgetary discipline and budgetary imbalance.

The role of the budget is to reflect what has been agreed upon by the decision-making institutions and the role of the financial system is to provide the necessary financial resources.

Once more Parliament turns out as the defender of the philosophy behind the treaty of Rome and the approach which was designed to facilitate and further the integration process.

This is not surprising when one recalls that Parliament was for many years the advocate of new common policies. With its draft treaty Parliament has once more invoked the need for new common policies. The distribution of roles assigned to, on the one hand, the budget, and on the other, the contents of the Community system reflects this list of priorities.

2. National policies versus common policies

An interesting feature of the draft treaty is that it takes on without any hesitation the distribution of responsibility between, on the one hand, national policies and, on the other, common policies.

This is a task the present Community has evaded with great skill to the detriment of the Community system as well as the budgetary system.

The draft treaty foresees that the Commission shall submit a report on the division between the Union and the member states of the responsibility for implementing common actions and the financial burdens resulting therefrom.

The Community would be well served if this task is carried out properly.

With regard to substance it would do away with the present mess where nobody knows which tasks are assigned to the Community (except for the common agricultural policy which, by the way, is gradually being renationalized by national subsidies) and which tasks are to remain at national level.

With regard to the budget such a division of labour would provide a much better possibility for making the necessary financial resources available because it could be proved that the national treasuries would witness lower expenditure in the areas where common policies were launched.

This is certainly a key feature in the draft treaty and it may be said without any reservations that the present Community or a future Community on the basis of the draft treaty - or another treaty - will only be viable if member states muster the political will to grasp the magnitude of this problem and find the necessary answers.

On top of the common agricultural policy, which should certainly continue to be a common policy, we would like to bring forward a few ideas of our own where the efforts wholly or partly could be transferred from national to Community level.

Industrial policy is a prime example. Not only could the Community pursue and increase efforts to improve the internal market but the common policy designed to promote industry in the entire European geographical sphere could be mapped out. In many circles it is feared that this would be a costly venture where the Community would take over lame-duck industries and run up the cost associated herewith. This is far from certain. The Community could be more selective. It could condition financial assistance on an equitable effort by private industry. It could provide equity capital instead of or as a supplement to loan capital. The ESPRIT programme is a case in point on how this could be done in a way which is agreeable, and hopefully profitable, to the Community, to the nation state and to private industry.

Research and technology also come to mind. In the United States or Japan there are not ten member states competing with each other in the same area. Europe should concentrate its research on common policies and common programmes. We should learn from the United States that only where research is linked to private industry do we get the necessary new technology. The task for Europe would then be to pool research and technology expenditure in sectors associated with the new technology and to provide the necessary framework for a fruitful cooperation between research institutes and private industry.

In the same breath Europe should build the necessary infrastructure to transfer knowledge, not only inside each individual nation state but also to the ten member states. Such an infrastructure could do two things for Europe. Firstly, it could launch Europe into the era of the information society by providing the necessary tool. Secondly, it would offer a springboard for European industry into this new era as a producer and a consumer. Let us not forget that the Roman Empire was based upon transport of people. The British Empire which emerged during the industrial revolution was based upon transport of goods. In the coming age it is transport of knowledge which will be decisive and if Europe does not master this we shall not be able to compete on an equal footing with USA and Japan.

These are only a few examples of what can and should be done at Community level. It illustrates the fact that the starting point in the draft treaty, namely national level versus Community level, is the right one. It also shows clearly that even if something, perhaps a lot, can be done without giving rise to expenditure, Europe will never be able to weather the point unless all member states show a much clearer commitment to increase the financial resources of the Community. It is also clear that such an attitude will only emerge if the Community and the Community institutions are able to demonstrate for which purposes they need the money and that the money will be spent in an efficient way for worthwhile projects covered by common policies.

3. Revenue

It is explicitly said in Article 71 that when this treaty enters into force the revenue of the Union shall be of the same kind as that of the European Communities. The Union inherits the revenue system from the European Communities. However, the Union may by an organic law amend the nature or the basis of assessment of existing sources of revenue or create new ones.

The revenue sources are thus customs duties, agricultural import levies and VAT.

As the only buoyant element is VAT we will limit our analysis to that particular element.

The draft treaty rejects the present system according to which an upper-limit for the call up per cent of VAT is determined in the treaty.

The Union may call up the amount of revenue necessary to finance the common policies adopted by the Council.

This is in conformity with the main philosophy advanced by the Parliament concerning which is the cart and which is the ox, . the Community system or the budget.

This approach is brought out clearly in Article 74, subparagraph 2, according to which a multiannual financial programme lays down the projected development in the revenue and expenditure of the Union. These forecasts shall be revised annually and be used as a basis for the preparation of the budget.

Thus the heart of the matter is that the multiannual programme sets forth an annual increase in expenditure which governs the annual increase in the call up per cent of VAT.

As we shall see when we analyse the expenditure side the distinction between obligatory and non-obligatory spending is rejected and there is thus no limit neither for the annual increase in expenditure, nor for the revenue sources.

Institutionally, the procedure means that the Council's exclusive powers on the revenue side of the budget are rejected in the sense that it is the Union which determines common policies, expenditures and therefore also the total amount of revenue.

This is undoubtedly a major step. The Council has up to now vigorously defended its exclusive powers with regard to the revenue side of the budget. The Commission's proposals[8)] to grant Parliament a say in increases of the VAT per cent above 1.4% were rejected with near-unanimity by the Council.

There has been no development for the last 6 - 12 months indicating that the member states would take a more favourable attitude towards granting Parliament powers on the revenue side.

There is no reason to hide that nearly all member states find it a hideous idea to transfer some of their taxation powers to the European Parliament regardless of the procedure it would involve.

It is just as clear that this is a cornerstone in the building proposed in the draft treaty. If the European Parliament does not receive powers with regard to Community revenue it does not make much sense to increase its powers with regard to expenditure and common policies because Council could block the use of such powers by limiting the available revenue.

The argument is often advanced that the European Parliament will never be a real Parliament without powers to tax the European citizens. It is certainly correct that no Parliament has ever manifested itself without taxation but there is not much prospect that member states are willing to cross that bridge at the present juncture.

Another argument to support taxation powers for Parliament is that it would mean a more "responsible" Parliament taking a more restrictive attitude towards expenditure. This may be right or wrong but to our mind the argument is a little bit out of context. Either it is a good thing to increase expenditure for common policies or it is a bad thing. Whether or not it would help to bring about a change in the mood of the European Parliament seems to be slightly irrelevant.

The virtues of basing the Community's finances on VAT are fairly clear. The VAT system is already working. The assessment base is well-known. It has been implemented in all member states. It is buoyant. It introduces a certain element of progressivity on the revenue side of the budget. So far, so good.

It is, however, to be regretted that the occasion has not been used to float ideas for other sources of revenue.

To do so is to invite criticism for being too fanciful. But to limit the Community's revenue to VAT will pose difficulties in two respects. Firstly, there is certainly a limit to the amount of VAT revenue which the member states will forgo. Secondly, the crucial element in the financing system - the connection between common policies and revenue sources - is not being pursued.

It would have been a good idea if the European Parliament had put forward proposals for other sources of revenue which go at least some of the way towards meeting these preoccupations.

One possibility would have been to propose an energy levy, either in the form of a direct levy on energy consumption or an energy import levy. Both possibilities are feasible and both could be combined with important progress towards a common energy policy in the Community.

Another idea could be to focus on nation state aids in the member states. According to Articles 92 - 93 of the treaty of Rome member states are authorized by the Commission to use state aids when certain conditions are fulfilled. The Community could go a step further and use the nation state aids as a tax basis for Community revenue. The system could work in the way that member states should pay a certain percentage, for example 10%, of authorized nation state aids into the Community budget. Such a system would certainly make it less attractive to operate a state aid system in member states. It would serve as a Community instrument to promote a more efficient industrial basis in the whole Community while at the same time providing a handsome revenue for the Community.

The draft treaty does not rule out that the Community may need new and other revenue sources. It is stated explicitly in Article 71, 2, that the existing sources of revenue may be amended or that the Union may create new revenue sources.

The provisions concerning revenue sources are therefore not totally static but dynamic in the sense that it is foreseen that the Community may not in the longer run be viable with a financial framework confined to the present revenue sources.

It is, however, doubtful whether it will be possible to introduce new revenue sources by means of an organic law. Indeed, it may be said to be highly unlikely that the member states will give up the need for ratification which is presently required to create new revenue sources.

The draft treaty maintains the present system where the member states collect the revenue. It is, however, foreseen that the Union may set up own revenue-collecting authorities. In legal terms, this seems to be superfluous. In any case it can be taken for granted that the member states will not be willing to establish such authorities.

4. Lending and borrowing

According to the treaty and the present financial regulations the Community can borrow on the international capital markets and lend the amount for specific purposes defined in a legal act adopted by the Council.

There is no general provision for the Community to borrow and lend. It can only be done when the Council has so decided and specified the amount and the aims. The legal act adopted by the Council is the pivot of the operations while the presentation in the budget is only for book-keeping purposes.

The draft treaty changes this situation.

The Union may authorize the Commission to issue loans. The maximum amounts are defined in the annual budget. It is explicitly said that borrowed funds may only be used to finance investments.

These provisions are not totally clear and not totally in conformity with Article 75 which says that the adopted budget must be in balance.

If we are dealing with a balanced budget, as is the case for the present Community budget, loans may clearly not be used to finance expenditures covered by the budget.

This problem could be solved if the draft treaty contained a provision for loan financing and opened the door for a budget where revenue would not equal expenditure but this is not the case.

Then we are more or less back to square one in the sense that loan operations can only be used for specific purposes in accordance with a legal act. If that is the idea it is difficult to see why the draft treaty should contain provisions on loan operations. If it is not the case it should be more clearly explained which role is assigned to lending and borrowing.

It is an open question whether the proposed lending and borrowing differ from the task already performed by the European Investment Bank.

The provisions concerning lending and borrowing are thus among the weakest and most elusive in the draft treaty, which is a pity because a more important and a more clearly defined role for lending and borrowing could definitely promote the integration process.

If, on the other hand, the idea is that loan financing is brought in when receipts do not equal expenditure to balance the budget we are in fact operating with a system where the budget ex definitione is balanced. Whenever there is a shortfall of revenue, loan financing builds the gap. Loan financing may thus be said to be an automatic residual.

It would have been helpful if the draft treaty had been clear on this point, that is whether a balanced budget means that receipts defined as revenue sources equal expenditure or a balanced budget means that receipts, including loan operations, equal expenditure.

5. Expenditure

Aside from doing away with the VAT ceiling the revenue side of the budget proposed in the draft treaty does not differ in principle from the present own-resources system.

The same analogy of continuation cannot be said to exist for the expenditure side which in several respects differs fundamentally from the present budgetary system.

Even if the general philosophy - common policies determine expenditure - is the same in the draft treaty as in the treaty of Rome and acquis communautaire several important changes are introduced in the draft treaty.

The first and most important one is that the draft treaty rejects the present distinction between obligatory and non-obligatory expenditure. All expenditure is treated on an equal footing with regard to annual increase and, as we shall see later, in the budgetary procedure.

This change is in conformity with the change in the legislative procedure which rejects the hitherto exclusive powers of the Council.

Analytically, it makes good sense to supplement the proposed legislative procedure with a budgetary procedure where all sorts of expenditure are subjected to the same rules and procedures.

There is no reason to distinguish between obligatory and non-obligatory spending if and when the present Community system is replaced by a system where the legal basis for expenditure is of a quite different nature.

We must bear clearly in mind that the draft treaty foresees a Community system, a legislative procedure and a budgetary system which differ substantially and in principle from the present system.

There will be no legal acts which automatically lay down the size of expenditure as it is the case for obligatory spending under the present rules.

There is no maximum rate of increase for non-obligatory expenditure, and the finely-tuned balance between Council and Parliament which is brought about by the present system is replaced by quite another balance of powers.

The annual increase for total expenditure is determined in the framework of multiannual financial programmes.

This is clearly one of the cases where the draft treaty hopes that political wisdom will prevail because it is not foreseen what happens if such programmes cannot be agreed upon or if they give rise to expenditure out of proportion with realities or what member states are willing to accept. It is said that the programmes shall be revised annually but that is one of many provisions which in themselves are admirable ones but at the same time open up for confrontation between the institutions and the member states.

The draft treaty contains a modest but very useful provision which the Community should have taken up long ago, namely to evaluate annually the effectiveness of the common policies in view of the costs associated therewith.

There is no doubt that for too long a period expenditure has gone on rising in the Community without a thorough analysis of the common policies and the common actions to prove whether the money is spent for the designed purposes and, if so, it is spent in the right way.

A cost-benefit analysis would do the Community a lot of good.

If the result were that some of the money was not well spent then the Community could make savings and by so doing prove that is is not acting as a blind man's buff.

If, on the other hand, the analysis proves that the money was well spent the Community would remove the suspicion that this is not so and be in a much better position to increase spending.

This provision in the draft treaty would be a very useful instrument when deciding on the division of responsibility between, on the one hand, the national level and, on the other, the Community level and it would go a long way towards providing the basis for the multiannual financial programmes. All assuming that the analysis is carried out in an efficient way and that failures are exposed and not stowed away.

6. Financial equalization

It is specifically said in Article 73 that a system of financial equalization shall be introduced in order to alleviate excessive economic imbalances between the regions.

It is, however, not said how such a system should work. The starting point for an analysis must be whether it should work on the revenue or on the expenditure side of the budget.

If the idea is to introduce a financial equalization system on the revenue side the effect would be a complete change in the own-resources system. We have seen in chapter II that the own-resources system does not take relative welfare into account. If this were to be done to ensure that member states with a GDP per capita below Community average should pay less than member states with a GDP per capita above Community average a complete recast of the system would be called for. Of course, such a change could be implemented if the member states were willing to do so. But it should not be obscured that it would mean a replacement of the own-resources system by quite another system.

In legal terms, the effect would be that revenue collected in the member states were not the property of the Community from the moment of collection because they had to be subjected to a multiplication factor reflecting relative welfare. Or in other words, the revenue had to pass through national treasuries in order to be reduced or increased by a multiplication factor and only after that process had been completed the amount would be transferred to the Community. Such a system is perfectly feasible but only if the national treasuries were introduced as an accounting machine between, on the one hand, the citizens and the enterprises and, on the other, the Community.

This point is more clearly seen when keeping in mind that the same effect could be obtained by paying in VAT according to the present rules and introducing a special levy on member states with a GDP per capita above Community average and a special subsidy on member states with a GDP below Community average.

The effects for VAT as an own resource have been analysed in a recent work by G. Isaac[9]. The conclusion is that a multiplication factor means that any idea of VAT as an own resource (illusory or real) cannot be maintained. In this case the Community will operate with a taux d'appel and not a taux d'imposition. If it is doubtful whether the VAT in its present shape is an own resource such doubts will not any longer persist if a multiplication factor is introduced.

It is doubtful whether such a system would bring about a real equalization. It would of course mean a transfer from rich to poor member states but it would not necessarily mean a transfer of money from rich to poor citizens.

This point can be illustrated by an example. Denmark would pay a sum of money to Greece but to do so all Danish citizens would be taxed regardless of their income and all Greek citizens regardless of their income would witness an alleviation of their fiscal burden. The implication would be that a poor Danish citizen would be taxed in order to alleviate the fiscal burden of a rich Greek citizen.

This is really the heart of the matter because it would mean that we are moving away from the idea of a Community to a more traditional pattern of international cooperation where member states are transferring money between each other. This can hardly be what the European Parliament wants.

To avoid this effect the equalization system would have to be introduced on the expenditure side.

It would mean that schemes to support poor regions and poor citizens would be implemented. The Social Fund is already performing this task with more or less success. Similar schemes or funds could be set up.

With the equalization system operating on the expenditure side of the budget we are back in the mainstream of Parliament's philosophy regarding the Community system and the role of the budget.

7. Budgetary procedure

In the present budgetary procedure (Article 203 of the treaty) we have the following distribution of powers between the institutions:

- The Commission proposes.
- The Council decides on a draft budget which is forwarded to Parliament. The Council takes the final decision with regard to obligatory spending. During the institutional interplay with Parliament, Council has an important say with regard to non-obligatory spending. It may even be said that Council by way of the maximum rate of increase exclusively can define the framework for non-obligatory spending but not its composition.
- The President of Parliament finally approves the budget. Parliament may forward modifications on obligatory spending but has no direct powers

in this area. With regard to non-obligatory spending Parliament has the final word but cannot surpass the maximum rate of increase without the consent of the Council.

It is thus the Council which has the upper-hand in this institutional interplay.

The draft treaty proposed by the European Parliament constitutes a sweeping change.

It is still the task of the Commission to forward a preliminary budget.

The Council finds itself stripped of all powers to decide and is relegated to the institution which makes amendments to the Commission's proposal so that Parliament can decide.

Parliament is the institution which in the end takes all decisions with regard to size as well as composition of the budget.

It is no overstatement to say that the budgetary procedure and the distribution of powers between the institutions have been completely turned around.

It becomes clear already in the first phrase which says that the Commission forwards the draft budget to the budget authority. According to Article 203 of the treaty the preliminary draft budget is forwarded to the Council.

Under the present rules it is the Council which establishes a draft budget by a Council decision and forwards it to Parliament.

This is not the case in Article 76 in the draft treaty. According to the proposed procedure the Council may approve amendments and the amended budget is forwarded to Parliament.

The implication of this is that unless Council agrees on an amendment the appropriations in the Commission's draft budget stand. Under the present rules there is no appropriation unless Council takes a decision with qualified majority.

It is a minor point but may not prove to be so in practice that amendments according to the draft treaty shall be approved by simple majority. In a Community of twelve member states, approval of amendments calls for the vote of seven member states. Judging by experience in recent years it is highly unlikely that seven member states may agree on an amendment and the proposed procedure would thus mean that the large majority of the appropriations proposed by the Commission would stand.

The next step in the procedure is a first reading by Parliament. Parliament may amend by an absolute majority the amendments of the Council. Parliament may also on its own initiative approve other amendments by a simple majority.

This brings out the general thrust of the proposal which is to increase Parliament's powers.

The third step gives the Commission the possibility to oppose amendments approved by the Council or by the Parliament. If the Commission chooses to do so the appropriations are referred back to the relevant institution which will have to make a fresh decision, this time by a qualified majority.

The fourth step gives the Council the right to amend the amendments approved by the Parliament. This can only be done by a qualified majority defined in Article 23, 2, b, as three fifths of the weighted votes cast.

After having done so the Council forwards once more the draft budget to Parliament which at its second reading may reject amendments of the Council by a qualified majority.

This finishes the budgetary procedure and Parliament finally adopts the budget by an absolute majority.

It is clear that the Council can never decide finally on an appropriation or reject amendments proposed by Parliament. The Council can only make amendments either to the original draft forwarded by the Commission or to the amendments approved by Parliament.

The only powers which are given to the Council are that by a qualified majority it can request the Commission to submit a new draft.

The proposed procedure is very complex, even Byzantine. It is difficult to see why and how such a procedure is proposed when the aim quite clearly is to transfer the decision-making powers from Council to Parliament.

It is difficult to see why the draft treaty in some cases proposes simple majority, in other cases qualified majority and in other cases again absolute majority.

It makes good sense to use different voting procedures under the present rules because of the distinction between obligatory and non-obligatory spending and the fine-tuned balance between Council and Parliament.

But it does not make much sense under the system proposed in the draft treaty which does away with the distinction between different types of expenditure and place the decision-making exclusively with Parliament. It looks as if the authors have wished to forward a procedure which at least bears some resemblances to Article 203 while not containing any of the important features of this article.

VII. The implication for economic integration

In the last 30 years economic integration, among other things in the shape of economic and monetary union, has played a predominant role in the academic and political debate. Many scholars have tried to map out how to facilitate and promote the economic integration and many studies have been produced.

As the European Community is the only genuine example of economic integration, it is only natural that many of the ideas have been put forward in the European debate and that many of the European experiences have served as basis for the academic debate.

In 1977 the Commission sponsored the MacDougall-report[10)] on the role of public finance in European integration.

The MacDougall-report is the main reference work to determine whether or not financial measures will promote the integration process.

It is both disappointing and regrettable that the provisions on finance in the draft treaty do not really make an attempt to take up the challenge of the MacDougall-report to design a budgetary and financial system suited to promote economic integration.

In fact, the MacDougall-report has pointed the way ahead in calculating the size of Community expenditure necessary for different stages of the integration process. It is said that in a pre-federal integration stage Community expenditure should rise to between 2% and 2.5% of total Community gross domestic product.

The next stage could be a federation with expenditure running at 5-7% of GDP (2-3 percentage points higher if defence expenditure is included). At this stage the European federation would encompass many common policies to increase productivity and living standard while at the same time alleviating regional differences.

In the final stage total Community expenditure would amount to 20-25% of GDP or perhaps even higher and then place a European federation on an equal footing with USA.

To our mind, the draft treaty would have stood a better chance if it had been based firmly on the solid theoretical background provided by the MacDougall-report.

This could have been done by incorporating in the draft treaty a gradual phasing in of higher Community expenditure as replacement for expenditure at a national level. Changes in the expenditure as well as the revenue could have been planned at pre-determined levels which would have given a clear picture of where the Community is going and how fast.

The MacDougall-report analyses efforts to equalize income differences in existing federations. It comes to the conclusion that interregional differences have been reduced by up to 40%, even if federal expenditure amounts to a very small size measured in terms of GDP. The exact figure for USA is federal expenditure amounting to between 2% or 3% of GDP to reduce interregional income differences by up to 40%.

Nor is it discussed or foreseen in the draft treaty whether we should use the Community budget to influence the business cycle.

It is quite evident that this has not been the case in the past because a budget of less than 1% of total Community GDP will not have any tangible effect on the business cycle.

This will, however, not be true if total expenditure rises and reaches for example between 3% and 5% of GDP and the possibility for influencing the business cycle will grow as expenditure rises in per cent of GDP.

It may or it may not be the intention of the authors to see the budget in such a role but the topic is not raised, either directly or indirectly.

The same applies to the distribution of responsibility between the private and the public sectors. In many member states this question is in the forefront of the political debate and the question of which tasks should be fulfilled by the public sector and which tasks should be taken up by the private sector is giving rise to many reports of different nature.

As a more specific measure, loan transactions can be used to promote a real European capital market. If and when lending and borrowing is included in the financing of the Community's activities the Community clearly forgoes a possibility to promote economic integration if the opportunity is not used for building a European capital market.

In the longer perspective there seems to be a gap in the analysis concerning the relationship between monetary policy and fiscal policy. If we are to establish an economic and monetary union in Europe we have to establish consistency between what is done by monetary policy and what is done by fiscal policy. There must, so to speak, be parallel progress. This is a point which has been elaborated by Allen and Kenen[11)].

They do not find a fiscal union absolutely necessary as a supplement to a monetary union. But it would certainly facilitate things a lot. The essential point is, however, that it is difficult to ensure consistency between monetary policy and fiscal policy if decisions are taken on different levels and in this respect the draft treaty poses a very serious problem, indeed. If total Community expenditure rises to a magnitude where it influences the business cycle and plays a role in the integration process fiscal decisions would be taken on national as well as Community level. It is far from certain that the same would be the case for monetary policy. In any case we would face an acute dilemma of economic policy decisions in different areas being taken on different levels with the clear risk that incompatible decisions are taken.

The finance provisions cannot be said to promote the integration process and the reader of the draft treaty is left with the impression that this aspect has not really been taken into account when the finance provisions were drawn up.

VIII. Conclusion

Our general appreciation of the finance provisions in the draft treaty is that it is primarily the institutional aspect which has interested the authors. The main goal has clearly been not only to increase Parliament's powers but to shift nearly all of the present powers invested in the Council to the Parliament. That may be good or bad according to political preference. Clearly the authors are of the opinion that it would be good but their case is not argued properly.

With regard to the specific provisions many of the proposals appear to be very cumbersome in practice. This goes for example for the complicated budgetary procedure in Article 76.

There is a certain logic in the institutional system put forward and the role assigned to budgetary and financial questions. The transfer of legislative powers from the Council to the Union and the removal of the distinction between obligatory and non-obligatory spending is a case in point, but that also means that weaknesses in the legislative and decision-making areas will have repercussions for the budgetary and finance provisions.

The general philosophy is coherent and very closely follows the one which lies behind the treaty of Rome, that is: the contents of the Community system determines the size and composition of the budget and the own-resources system provides the necessary financial means.

It is, however, regrettable that the authors have focused so narrowly on the institutional aspect of the finance provisions that the possibility for shaping a budgetary and financial system in harmony with the development of new and other common policies has not been used.

Member states are required to accept very important changes. Firstly, the expenditure level and accordingly also the revenue is fixed by the Union without any ceiling. Secondly, the Union may by an organic law (no ratification is required by member states) introduce other revenue sources than the existing ones.

Judged by recent experience it is not likely that the proposed transfer of powers to the European Parliament and the far-reaching changes regarding revenue sources will be supported by member states.

1) Treaty amending Certain Budgetary Provisions of the Treaties establishing the European Communities and of the Treaty establishing a Single Council and a single Commission of the European Communities, referred to as Budget Treaty 1, which was signed on 22 April 1970 (see Official Journal of the European Communities, No. L 2 of 2 January 1971).

2) Budget Treaty 2, signed on 22 July 1975, was published in the Official Journal of the European Communities, Brussels, No. L 359 of 31 December 1977.

3) Decision of 21 April 1970 on the replacement of financial contributions from member states by the Communities' own resources. OJ L 94 of 28th April 1970.

4) Council Regulation (EEC) No. 1172/76 of 17th May 1976 setting up a financial mechanism. OJ L 131 of 20th May 1976.

5) See "Member States and the Community Budget", by J. Ørstrøm Møller, Copenhagen 1982.

6) "Financing the European Economic Community" by J. Ørstrøm Møller. National Westminster Bank Quarterly Review, November 1983.

7) Proposal submitted by the Danish Government in August 1983.

8) The future financing of the Community. Draft decision on new own resources. Communication from the Commission to the Council. COM(83)270 of 6 May 1983.

9) Isaac, G.: "Quelles Ressources pour la Communauté Européenne ?" Presented to C.E.D.E.C.E., Toulouse, 18 - 20 October 1984.

10) MacDougall Report: The Role of Public Finance in the European Communities, EC Commission, Brussels, 1977.

11) Allen, P.R. and Kenen, P.B.: "Asset Markets, Exchange Rates and Economic Integration: A synthesis", Cambridge University Press, New York, London 1980.

November 1984

Table 1

Distribution of payments appropriations 1973-1984

		1973		1974		1975		1976		1977	
		UA	Pct of total	UA	Pct of total	UA	Pct of total	UA	Pct of total	UA	Pct of total
1.	Administration	240	6.0	337	7.5	375	5.8	420	5.8	497	5.7
2.	Research, technology, energy	72	1.8	78	1.7	116	1.8	118	1.6	143	1.6
3.	Reimbursement and support to member states	236	5.9	284	6.3	354	5.5	472	6.5	665	7.6
4.	Regional Fund	-	-	-	-	91	1.4	277	3.8	372	4.3
5.	Special arrangements to Britain	-	-	-	-	-	-	-	-	-	-
6.	Social Fund	50	1.2	237	5.3	136	2.1	256	3.5	317	3.6
7.	FEOGA guarantee	3,174	79.3	3,278	72.6	4,822	75.2	5,365	73.6	6,167	70.9
8.	FEOGA structure	124	3.1	128	2.8	184	2.9	218	3.0	297	3.4
9.	Third countries	105	2.6	169	3.7	324	5.1	137	1.9	216	2.5
10.	Miscellaneous	4	0.1	5	0.1	9	0.2	24	0.3	31	0.4
	Total	4,005	100	4,516	100	6,411	100	7,287	100	8,705	100

1978		1979		1980		1981		1982		1983		1984 1)	
ECU	Pct of total	ECU	Pct of total	ECU	Pct of total	ECU	Pct of total	ECU	Pct of total	ECU	Pct of total	ECU	Pct of total
676	5.7	773	5.4	820	5.0	943	5.3	1,010	5.0	1,162	4.6	1,237	4.5
192	1.6	254	1.8	290	1.8	377	2.1	438	2.1	481	1.9	626	2.3
662	5.5	727	5.1	791	4.9	956	5.4	1,049	5.1	1,089	4.3	1,150	4.2
255	2.1	513	3.6	727	4.5	799	4.5	973	4.8	1,256	5.0	1,413	5.2
-	-	-	-	174	1.0	1,248	7.0	1,819	8.9	1,672	6.7	1,202	4.4
285	2.4	596	4.1	735	4.5	746	4.2	906	4.4	891	3.6	1,220	4.5
9,279	77.5	10,435	72.6	11,307	69.4	10,988	61.8	12,404	60.8	15,812	63.1	18,376	67.4
324	2.7	403	2.8	601	3.7	575	3.2	646	3.2	653	2.6	675	2.5
265	2.2	405	2.8	509	3.1	859	4.8	786	3.8	992	4.0	897	3.3
35	0.3	271	1.8	335	2.1	302	1.7	392	1.9	1,052	4.2	453	1.7
11,973	100	14,367	100	16,289	100	17,793	100	20,423	100	25,061	100	27,249	100

Source: For 1973-1982: Court of Auditors' Annual Report.
For 1983-1984: The annual budget published in the Official Journal of the European Communities.

1) Including supplementary and amending budget No. 1 for 1984.

Table 2

Development of the Community's own resources 1973-1984. Million ECU

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
Agricultural import levies												
- Amount	411.4	255.0	510.4	1,035.2	1,576.1	1.872.7	1,678.6	1,535.44	1,264.9	1,522.0	1,347.1	1,946.7
- Pct. of own resources	-	-	-	-	-	-	10.3	8.6	6.7	6.9	5.9	7,7
Sugar levies												
- Amount	98.4	75.1	79.7	128.5	202.4	406.2	464.9	466.94	482.5	705.8	948.0	1,003.3
- Pct. of own resources	-	-	-	-	-	-	2.8	2.6	2.4	3.2	4.1	4.0
Customs duties												
- Amount	1,986.8	2,737.6	3,151.0	4,064.5	3,927.2	4,390.9	5,189.1	5,905.7	6,392.4	6,815.3	6,988.6	7,623.5
- Pct. of own resources	-	-	-	-	-	-	31.7	33.1	32.3	30.9	30.4	30.3
Financial contribution 1)												
- Amount	2,257.5	1,904.0	2,152.0	2,482.1	2,494.5	5,329.7	2,302.1	-	151.4	197.0	217.7	-
- Pct. of own resources	-	-	-	-	-	-	-	-	-	-	-	-
VAT												
- 1 pct. of assessment basis	-	-	-	-	-	-	9,047	9,910	11,680	12,974	13,719	14,608
- Pct. of own resources	-	-	-	-	-	-	55.2	55.6	58.9	58.9	59.6	58.0
- Call-up pct. (VAT pct.)	-	-	-	-	-	-	-	0.73	0.78	0.92	0.99	0.99

Source: Preliminary draft budget for 1985, Volume 7, page A/68, A/69, A/72.

1) From 1973 to 1978 all member states paid financial contributions and no member states paid in VAT contributions. 1979 was a transitional year. Six member states paid VAT contributions and three member states financial contributions. From 1980 nine member states have paid VAT contributions and Greece has paid financial contributions as the uniform assessment basis has not yet been implemented in Greece.

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