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Article

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Intereconomics

Suggested Citation: Kengyel, Ákos (2016) : New Headings – Old Problems: The Evolution and Future of the EU Budget, Intereconomics, ISSN 1613-964X, Springer, Heidelberg, Vol. 51, Iss. 2, pp. 100-106,
<https://doi.org/10.1007/s10272-016-0584-0>

This Version is available at:

<https://hdl.handle.net/10419/191154>

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Ákos Kengyel

New Headings – Old Problems: The Evolution and Future of the EU Budget

Despite its political significance the size of the European Union's budget is rather modest: the expenditures make up less than one per cent of the EU's Gross National Income. This article aims to examine the long-term problems linked to the budget. Critical analysis of characteristic features of the EU budget is particularly important, as we argue the Multiannual Financial Framework 2014-2020 maintains the "old" problems, and we suggest that a more comprehensive long-term reform is necessary. Under such circumstances, it is worthwhile to reflect on the tasks, functions and structural problems of the budget and on how to use available resources in a more structured and efficient way.

The EU budget has changed significantly as the Union itself has evolved from the original customs union to an economic and monetary union. The EU's responsibility for policy-making and for policy management varies enormously across its range of policy interests. In those spheres where significant responsibilities are exercised, arrangements are usually well established, and effective policy instruments – legal and financial – are usually available. However, it is by no means obvious what the EU budget is for. It should be emphasised that the size of the EU budget is rather modest: the expenditures make up less than one per cent of the EU's gross national income (GNI). This one per cent ceiling represents an extremely low level of redistribution,¹ especially in view of the continual deepening of European integration, the growing number of EU tasks and the enlargements of the Union (which widen the development gaps among countries).

¹ It should be noted that even the MacDougall Report in 1977 proposed a considerable increase in the size of the EU budget: first up to 2.5 per cent of GDP and later to five or possibly ten per cent in order to fulfil macroeconomic stabilisation functions. These suggestions have never been seriously discussed among the member states. See D. MacDougall, D. Biehl, A. Brown, F. Forte, Y. Fréville, M. O'Donoghue, T. Peeters, R. Mathews, W. Oates: Report of the Study Group on the Role of Public Finance in European Integration, Volume I: General Report, Brussels 1977, European Commission.

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Functions of the budget

The most important function of the EU budget is, unquestionably, to support common policies. Within this general aim, the ability of policies to strengthen cohesion and to accelerate the development of less developed member states is of strategic importance, especially since eastern enlargements have significantly increased the development gaps within the Union. The implementation of EU-level policies requires the establishment of appropriate support mechanisms.² Another characteristic of common policies is that once a policy has been established, it is not so simple to ensure a "fair" share of the EU budget for all member states unless the given policy is distorted to the point that the original objective is undermined.

Member states naturally consider the appropriate balance between their contributions and the transfers they receive to be of great significance. It is fair to expect the net balance of a given country to be in line with its level of development. Actually implementing this, however, raises several problems. Even if all member states take part in the financing of the budget proportionally to their economic performance, the automatism that characterises the operation of most common policies makes it difficult to determine in advance a proportional distribution rate among member states. If it should prove impossible to arrive at an acceptable system for financing the budget that would ensure both proportionate financing and the successful implementation of policies, then in the future

² See R. Baldwin, C. Wyplosz: *The Economics of European Integration*, Berkshire 2004, McGraw-Hill Education.

deals on compensation packages might determine the result of negotiations on the EU budget. This would not be a desirable element in the normal operation of the EU budget.

There are no precise, legally determined procedural rules related to the governmental role of the EU. Perhaps the only concept that gives us orientation is the principle of subsidiarity, according to which no competences should be given to the EU unless all those concerned derive more benefit from supranational decision-making.³

Traditionally, governments undertake the following functions, which entail different levels of budgetary responsibilities:

- *Allocation function*: The government intervenes to make adjustments for the failure of the market to achieve allocation efficiency.
- *Distribution function*: In this case, the intervention is not directed at the efficiency of the operation of the market, but at the distribution of the achieved wealth.
- *Development function*: The intervention plays an important role in improving the preconditions for better economic performance, such as investment in infrastructure and human resources.
- *Stabilisation function*: Governments use fiscal and monetary means to correct macroeconomic imbalances (inflation, unemployment, slow growth, current account problems, etc.).
- *Regulatory function*: This includes the establishment and supervision of a framework ensuring the proper functioning of market forces and rules to regulate the behaviour of individuals.
- *Public service function*: National budgets provide public goods and services.

Relatively few of these functions are carried out at the EU level, and of these only a few have budgetary implications. Currently, EU budgetary transfers relate mostly to expenditures linked to agricultural and regional policies, and as such the EU fundamentally performs allocative and distributive tasks. In addition, a clear development function can be seen. The primary aim of current transfers is redistribution, as funds are essentially transferred

3 For details, see I. Begg: Fiscal Federalism, Subsidiarity and the EU Budget Review, Swedish Institute for European Policy Studies, Report No. 1, 2009.

from wealthier regions to poorer regions, or from consumers and taxpayers to farmers. Most policy areas of redistribution, however, are untouched.⁴ In addition to regional development transfers, the development functions are also supported by EU expenditures on R&D activities, the construction of the Trans-European Transport Network and the development of human resources through education programmes. As the single market develops, the regulatory function of the EU is becoming more and more significant. However, this has very few budgetary implications.

The economic stabilisation function is almost exclusively in the hands of national governments – with the exception of monetary policy. In order to promote the European economy's balanced and more dynamic growth, the effectiveness of the stabilisation function needs to be improved.⁵ Based on the attitude of member states, however, it seems unrealistic that the stabilisation function will in future be exercised through the EU budget. The macroeconomic revitalisation of the sluggishly growing European economy will therefore remain the task of economic policy coordination among the member states, supplemented perhaps by a few EU level initiatives. The size of the EU budget in itself makes it unsuitable for playing a role in macroeconomic stabilisation.

The size and the structure of the EU budget

Both the size and structure of the EU budget have changed dramatically since the beginning of the integration process. At first, most of the budget was spent on subsidising the Common Agricultural Policy (CAP). With the deepening of integration and the increase in the number of members, the EU budget has undergone gradual changes. The desire to strengthen cohesion among member states became a priority: from the end of the 1980s, the role of the Structural Funds started to grow stronger. The financing of the other common policies, however, remained marginal. The two dominant policies' share of budget expenditures has remained almost unchanged in the various budgetary periods, at around 70-80% of the total spending. Naturally, in the meantime several shifts have occurred in the regulation of these two areas, both in terms of content and approach.

Since 1988 the EU has prepared medium-term budgetary plans – Financial Perspectives and the Multiannual Financial Frameworks (MFF) – which contain a multi-

4 For example, the EU budget is not concerned with welfare transfers, health insurance, or public goods and services, such as defence.

5 Even before the global crisis, its importance was clearly explained in J. Pelkmans: European Integration. Methods and Economic Analysis, Harlow 2006, Financial Times Prentice Hall.

nual spending plan. These provide much more stability in the financing of the various items and in guaranteeing the funding of multiannual programmes. In this way, the annual budgetary debates are held within the key figures of the multiannual framework. Actual expenditure gradually increased in the period 1988-1999 from 1.15% to 1.22% of GNP. Between 2000 and 2006 it was only 1.07%. Then, due to the firm opposition of the big net contributor countries, payments decreased to 1.00% of GNI in 2007 and further declined to 0.95% in the period 2014-2020. At the same time, in absolute terms, the available sum continued to increase: the average size of the annual budgets increased from €47 billion (then ECU) in the period 1988-1992 to €130 billion in the period 2014-2020. However, measured in comparable prices, there has actually been a 3.7% decrease in real terms compared to the period 2007-2013 (see Table 1).

Unfortunately, during budget debates the main aim of all member states is to decrease their payment obligations as much as possible and to achieve the most favourable net balance possible. It can be stated that since 2000, the EU budget is no longer fundamentally determined by the real objectives of common policies. Instead, it functions the other way around – the available resources determine the financing of policies. The attainment of a net position that is deemed acceptable takes precedence over all other considerations.⁶

Unsolved problems of the revenue side

If the EU had its own resources – which would give it a kind of financial autonomy – this would be of great importance for the appropriate operation of the EU budget. However, because member states cling to the independence of their national fiscal policies and staunchly protect their own tax policies and tax revenues, the EU has consistently had no or insufficient own resources, and consequently, the EU budget depends almost exclusively on national budgets and the political will of the member states. Given this, it is not surprising that member states are primarily concerned with their net position in the EU budget – to the exclusion of nearly all other factors. Unfortunately, under these circumstances we cannot expect, even in the long run, that the EU will have a more significant budget that is able to fulfil more functions.

6 This situation also draws attention to the institutional problems of the budgetary debates, as the final agreements about the budget are concluded by the member states. Proposed by the European Commission, the regulation laying down the MFF must be adopted by the Council by unanimity after obtaining the consent of the European Parliament. The Commission and the Parliament have relatively limited lobbying power when the deals are made.

Table 1
Breakdown of expenditure headings in the budgetary periods 1988-2020

in %

| | 1988-1992 | 1993-1999 | 2000-2006 | 2007-2013* | 2014-2020* |
|-----------------------------------------------------------|-----------|-----------|-----------|------------|------------|
| 1. Agricultural policy | 58 | 48 | 46 | 42 | 38 |
| Market support and direct payments | 58 | 48 | 41 | 34 | 29 |
| Rural development | - | - | 5 | 8 | 9 |
| 2. Structural operations (regional policy) | 22 | 33 | 33 | 36 | 34 |
| 3. Internal policies | 4 | 6 | 6 | 10 | 16 |
| 4. External activities ** | 5 | 7 | 9 | 6 | 6 |
| 5. Administration | 9 | 5 | 5 | 6 | 6 |
| Financial reserves | 2 | 1 | 1 | - | - |
| Average annual payments (billion ECU/euro, current price) | 46.94 | 72.18 | 91.64 | 117.25 | 129.77 |
| Payments as a % of GNP/GNI | 1.15 | 1.22 | 1.07 | 1.00 | 0.95 |
| Upper limit of own resources as a % of GNP/GNI *** | 1.18 | 1.23 | 1.27/1.24 | 1.23 | 1.23 |

Notes: * The expenditures in the periods 2007-2013 and 2014-2020 are presented according to the structure of earlier periods. ** External activities also include the pre-accession instruments heading, which was introduced as a separate heading in the period 2000-2006, amounting to three per cent of the budget. *** In 2002 the GNI-based system of calculation was introduced, according to which 1.27% of GNP was equivalent to 1.24% of GNI.

Sources: Interinstitutional Agreements. Official Journal of the European Communities, L 185, 15.07.1988.; OJ C 331, 22.11.1993.; OJ C 172, 18.06.1999.; OJ 2006/C 139, 14.06.2006.; Council Regulation (EU, EUR-ATOM) No. 1311/2013 of 2 December 2013 laying down the multiannual financial framework for the years 2014-2020. OJ L 347, 20.12.2013.

However, there are some real own resources among the revenues of the EU budget. In this respect, the first significant change occurred in 1970, when national contributions were replaced by a system of own resources. It was decided that customs duties and the agricultural levies prevailing at that time would become revenue sources for the EU budget.⁷ Originally, ten per cent of customs duties could be retained to cover the cost of collection. Later, this share increased to 25% and since 2014 it has been set at 20%. Nowadays, the so-called traditional own resources make up around 12% of EU budget revenues. As revenues from traditional own resources proved to be too low after a while, the introduction of a new resource be-

7 European Commission DG Budget: The origins of the own resources system and its successive reforms, Office for Official Publication of the European Communities, Luxembourg 2007.

came urgent. Beginning in 1980, one per cent of the VAT base had to be contributed to the EU budget. In 1986 this was increased to 1.4%, and then after gradual decreases between 1995 and 1999 the contribution level was reduced back to one per cent. In 2002 it was decreased to 0.75%, and in 2004 to 0.5%. Since 2007, just 0.3% of the harmonised VAT base is transferred to the EU budget. VAT-based contributions currently make up about ten per cent of EU budget revenues.

In 1988 GNP-based contributions were introduced. These were replaced by the GNI-based system in 2002, according to which all member states contributed the same percentage of their GNI. For net contributor countries, there are some concessions: a reduction is often given to them with respect to their GNI-based contributions. While member states' GNI-based contributions represented ten per cent of the EU budget in 1988, they now amount to about 75% of EU budget revenues. The budget has a few other own resources as well. Such revenues include the income taxes paid by EU employees, contributions to EU programmes paid by non-EU countries and fines imposed on companies based on competition policy. In addition, there are correction mechanisms to correct budgetary imbalances considered "excessive" – including the UK rebate and lump-sum payments.⁸

Because of the gradual decrease of revenues from traditional own resources, EU budget revenues are increasingly linked to gross contributions proportionate to GNI. As a result, the EU budget is predominantly financed through the direct transfers of member states. This process undermines the own resources-based budget principle and the EU's financial autonomy. Although several proposals have been developed during the past multi-annual frameworks negotiations, for the time being no general agreement has been reached concerning new resources.⁹ Other possible candidates for new own resources could be a share of a financial transaction tax, an EU charge related to air transport, a separate EU VAT

rate, a share of an EU energy tax or an EU corporate income tax.

The Commission's proposal for the MFF 2014-2020 included a new and fairer system of financing the EU budget that would reduce GNI-based contributions due to new proceeds from a future financial transaction tax for the EU budget and a new modernised VAT-based resource. The negotiations brought no significant changes, and consequently a high-level group on own resources was established in February 2014 to suggest possible improvements to that system. The group will deliver its final recommendations by the end of 2016.¹⁰ It is evident that the new resources system should fulfil the following three criteria: provide a relatively stable level of revenue, be independent of member states' budgetary situations and be proportionate to the level of development of the various member states.

Characteristics of the expenditure structure

The expenditure structure of the EU budget for the periods 2007-2013 and 2014-2020 represented a change from the previous structure: the CAP is no longer the largest expenditure heading; instead, interventions to improve competitiveness are at the top of the budgetary lines (see Figure 1). The new headings clearly indicate which issues and objectives need to be funded through the EU budget to meet the strategic objectives of the Union.¹¹ However, the volume of expenditures raises the issue of how well the available amounts contribute to the creation of a more competitive European economy, i.e. in achieving the goals expressed in the Europe 2020 Strategy.¹²

Expenditures on competitiveness for growth and employment (heading 1a) increased from €91.5 billion (9.2% of the 2007-2013 budget) to €125.6 billion (13.1% of the 2014-2020 budget), expressed in 2011 prices. While this is a positive development, it also means that this head-

8 Denmark, the Netherlands and Sweden benefit from gross reductions to their annual GNI contributions of €130 million, €695 million and €185 million respectively. Austria has benefited from gross reductions in its annual GNI contributions of €30 million in 2014 and €20 million in 2015, and will receive a €10 million reduction in 2016. Call rates for the VAT-based own resource for Germany, the Netherlands and Sweden are fixed at 0.15%. See European Commission DG Budget: Own resources in 2014-2020 MFF, Brussels 2015.

9 For example, even the Agenda 2000 made several justified proposals. See European Commission: Agenda 2000. For a Stronger and Wider Union, DOC/97/6, Strasbourg 1997. See also a detailed study on possible tax-based own resources that was commissioned by the European Parliament: European Parliament Directorate-General for Internal Policies of the Union: Future Own Resources. External Study on the Composition of Future Own Resources for the European Parliament DG Internal Policies, Brussels 2007.

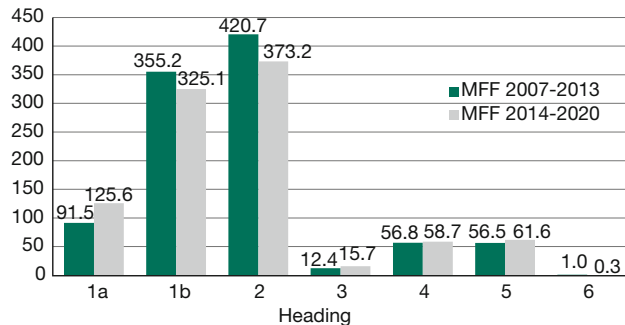
10 Mario Monti, the chair of the high-level group, emphasised that "we must not simply look at different potential resources technically ... but also at the forces at work which explain why a reform can succeed or fail. I am convinced that the EU budget's potential for supporting our common policies and bringing 'adding value' to EU spending remains underutilized." See European Commission: A way forward for financing the EU budget: Mario Monti presents the First Assessment Report by the High Level Group on Own Resources, Brussels 2014.

11 See European Commission: Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. A Budget for Europe 2020. Part I.-II. {SEC(2011) 867 final} {SEC(2011) 868 final}, COM(2011) 500 final, Brussels 29 June 2011.

12 Council of the European Union: Council Regulation (EU, EURATOM) No. 1311/2013, in: Official Journal of the European Union, L 347, 2 December 2013, pp. 884-891.

Figure 1
Comparing the 2007-2013 and 2014-2020 MFF
commitment appropriation

in EUR billion



Note: 1a: Competitiveness for growth and jobs; 1b: Economic, social and territorial cohesion; 2: Sustainable Growth: Natural Resources; 3: Security and citizenship; 4: Global Europe; 5: Administration; 6: Compensations – for Bulgaria and Romania in 2007-2009 and for Croatia in 2014. Figures expressed in constant 2011 euros.

Source: European Commission: Multiannual Financial Framework 2014-2020, MFF in Figures.

ing's share of the total budget remains relatively modest. However, there are three fields within this heading upon which significant changes were agreed.¹³ In the field of education and training policy, the Erasmus+ programme has a budget of almost €15 billion in current prices (€13 billion in 2011 prices), which is more than 40% higher than former levels in real terms. The other important field is research and innovation policy, for which the Horizon 2020 programme has a budget of almost €80 billion in current prices (€70 billion in 2011 prices), which represents around a 30% real increase compared to the former framework. The third most important field worth mentioning is the new Connecting Europe Facility (CEF). The CEF supports strategic infrastructure investment at the European level in the transportation, energy or ICT sectors with €33.3 billion in funding at current prices (€29 billion in 2011 prices) – €26.3 billion for transport,¹⁴ €5.9 billion for energy and €1.1 billion for digital infrastructure. The CEF budget represents a 50% increase over the Trans-European Networks budget.

The expenditures on cohesion policy (heading 1b) decreased by eight per cent from the first funding period

¹³ For a brief summary of the main changes, see European Commission: One trillion euro to invest in Europe's future – the EU's budget framework 2014-2020, Press Release IP/13/1096, Brussels, 19 November 2013.

¹⁴ This consists of €15 billion from Heading 1a and €11.3 billion ring-fenced for the CEF in the Cohesion Fund under Heading 1b (in current prices).

to the second, from €355 to €325 billion in 2011 prices. Sustainable Growth: Natural Resources (heading 2) will receive a total of €373 billion throughout the 2014-2020 period, of which €278 billion is for market-related expenditure and direct payments (pillar 1) and €85 billion is for rural development (pillar 2) within the CAP. It is worth mentioning that the CAP still made up around 70% of the total EU budget in 1984. There has clearly been a gradual decrease since then, although the CAP's share of the EU budget has remained among the highest. The other four headings more or less maintained the same share of funding in the current MFF as they received in the previous one.

In conclusion, while we recognise that remarkable shifts were agreed to in connection with some policy areas, the main structure of budgetary expenditures at the EU level reflects the traditionally developed division of expenditures. This means that, all together, 72% of expenditures in the period 2014-2020 go towards agricultural and cohesion policies (see Figure 2).

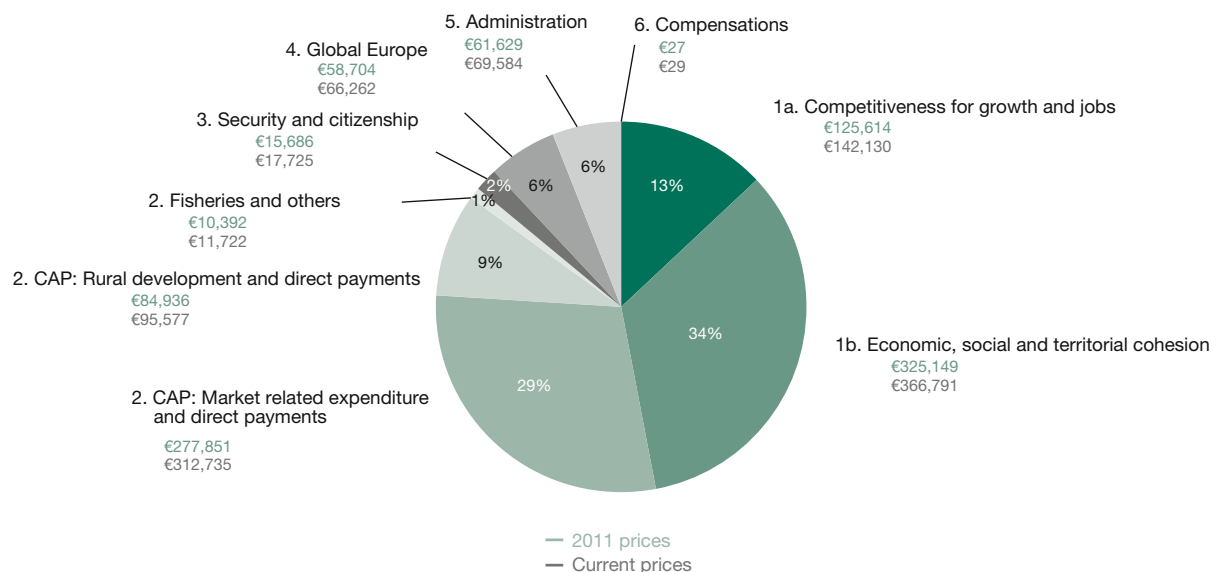
Concluding remarks

The dominance of agricultural subsidies and regional development expenditure during the history of the European Union's budget clearly indicates that the primary aim of member states with regard to the EU budget is to use it for redistributive purposes instead of for promoting the achievement of other common objectives of the Union. The economic stabilising function has remained almost exclusively in the hands of national governments – with the exception of monetary policy. Changes in the governmental functions of the EU might arise in connection with ensuring the adequate functioning of the economic and monetary union, as it is uncertain whether economic policy coordination among the member states will prove to be sufficient in the long run to manage the monetary union and solve the serious problems that have emerged in the eurozone.

The fact that the EU budget is predominantly financed via direct transfers by member states – and that consequently each state's net position has become its primary concern – makes it very difficult to apply radical changes to the expenditure structure. The small proportion of the EU's real own resources undermines the own resources-based budget finance principle and the EU's financial autonomy. Therefore, the long-term future of the EU budget greatly depends on reforms of the revenue side. The new resources should fulfil the following three criteria: be independent of national budgets and member states' political will to finance the EU budget, provide a relatively

Figure 2
Commitment appropriations in the MFF 2014-2020

in millions



Source: European Commission DG Budget, 2015.

stable level of revenue, and be proportionate to the development level of the various countries.

Despite the new budgetary headings, it can be concluded that the budgetary frameworks for the periods 2007-2013 and 2014-2020 do not represent a radically new expenditure structure. These budgets are fundamentally characterised by the continuation of the “historically developed” expenditure structure, with only minor changes in proportions. The “special treatment” of agricultural policy, which is almost universally regarded as extremely costly, has not been ended, but the expenditures are gradually decreasing. Partly as a result of this approach, the main instruments for strengthening the competitiveness of the European economy (e.g. through R&D, educational programmes) have not been allocated significantly higher shares in the budget; however, some serious shifts have begun that could increase the budgetary background of these policies.

When reflecting on a more desirable expenditure structure, it is worth considering the lessons of the debates over the current expenditure structure, the competitiveness problems of the EU, the need for strengthening cohesion and the ability to make better use of the opportunities offered by the single market. In addition, it should be taken into account that the member states clearly insist on the pre-eminence of their national budgets and

are therefore rather cautious with regard to significant increases in spending at the EU level. This is true even for policy areas in which there is considerable agreement on the need for development resources, but for which the financing was not previously envisaged as coming from a strengthening of the role of the EU.

Nevertheless, the primary outlines of the desirable shifts for the long-term future structure of EU expenditures can be defined.¹⁵

First, research and development has to play a prominent role in improving the competitiveness of the European economy. In addition to national budgets, the EU must also undertake a larger role in supporting research and innovation activities. The support should of course be based on well-formulated objectives and criteria. The main objective would not be to increase the ratio of research conducted using public funds but to mobilise private resources to a greater extent.

Second, the European economy can only become more competitive if significant development is achieved in

15 See Á. Kengyel: Reflections on the desirable expenditure structure of the EU budget. An individual contribution to the debate. In: The European Union after the Treaty of Lisbon. Global Jean Monnet / ECSA World Conference 2010. European Commission Education and Culture DG, Brussels, May 2010, p. 16.

education and training, both in terms of the institutional system and the content. More flexible forms of training and content changes that take into account economic and technological development are needed. To achieve this, stronger ties between education and economic life should be fostered. At the EU level, the main task should be to promote cooperation among member states and increase student mobility.

Third, the single market can only operate well if there is an adequate base of physical infrastructure and the various networks are connected. Therefore, the construction of trans-European networks should receive special attention. The development of transportation networks requires more European funding, as the slow implementation of investments so far has led to a current situation that is very unfavourable.

Fourth, the success of the entire integration process depends to a great extent on economic and social cohesion among member states and regions. In order to exploit the advantages of the single market and to create the conditions for fair competition, there is a need to enhance the competitiveness of less developed regions. To achieve this aim, cohesion policy has to be sustained, and its role in reducing disparities needs to be strengthened.

Fifth, a radical reform of agricultural policy is needed, as the subsidy system that has evolved over the past decades has proved to be both extremely costly and quite inefficient. The CAP has already achieved the majority of its original objectives, which is another reason for changing it. Agricultural funding should be used exclusively to fund development and modernisation directly linked to agricultural production. Complex rural development should be incorporated into cohesion policy.

Finally, in addition to expenditures related to the long-term competitiveness of the European economy, there are several other policies at the EU level for which funding instruments are necessary. Two such fields are policies concerning cooperation in justice and home affairs, and external relations.

It is a question whether the member states would be able to initiate and agree to significant changes in the longer term and thus adopt an EU budget with a more efficient expenditure structure. This would be the only way to make much better use of the very limited amount of resources available at the EU level. To achieve this aim, the financing problems of the budget would also have to be solved. A definitive shift towards real own resource-based financing would be the only way to provide a firm foundation for effective budgetary expenditures at the European Union level.