THE EUROPEAN UNION’S ACCOUNTABILITY DEFICIT

M. Peter VAN DER HOEK¹

Abstract: The literature often addresses the European Union’s “democratic deficit”. This paper addresses a problem that could be called the “accountability deficit”. The European Court of Auditors has never issued an unqualified positive opinion on the legality and regularity of the EU budget execution. The European Commission has developed several instruments to further the member states accountability of EU funds. This paper argues that one of these instruments, the member state declaration, seems promising and describes the Dutch experience.

Key words: accountability deficit, European Court of Auditors.

1. Introduction

Traditionally, three branches of government are distinguished in public finance:

1. Allocation branch

This branch pertains to the influence of government on the use of the factors of production. The market is unable to provide for certain goods and services, in particular public goods. This is called market failure. Another possibility is that the market does work, but not very efficiently, for example due to externalities, monopolies, etc. In these instances of market imperfections government intervention may lead to a more efficient market outcome, in particular if government is able to abolish externalities or monopolies or to regulate them effectively.

2. Distribution branch

This branch pertains to the government's influence on the size distribution of real incomes. In the 19th century, the prevailing view in Europe was that government should leave the income distribution as it resulted from the production process and governments were focused on distributional neutral taxation. But in particular from World War II, European governments tend to assume responsibility for the size distribution of incomes. Thus, income redistribution has become a distinct goal of public policy.

3. Stabilization branch

Since Keynes we know that government, at least in theory, can bring about a macro-economic equilibrium. In the Keynesian view, public expenditures and revenues are considered instruments of macroeconomic policy. Key to this branch is the circular flow effect, that is, the government's influence on aggregate supply and demand. Since the worldwide economic crisis that became apparent in 2008, virtually all governments have pursued Keynesian policies after they had abandoned them in the 1970s (van der Hoek, 1999).

¹ Erasmus University Rotterdam, Netherlands.
The existence of a European Union budget is not self-evident. The EU is not (yet) a federation, but rather a hybrid phenomenon with both supranational and intergovernmental characteristics. It would be conceivable that the EU is funded on the basis of grants provided by the member states.

National budgets are much bigger than the EU budget, which amounts to approximately 1% of GDP. As a result, the EU cannot pursue a stabilization policy. In 2008, the EU’s revenues amounted to €124.1 billion and consisted of the following categories (between brackets the share of each category in total revenues):

1. Traditional own means: agricultural levies and customs duties (14%).
2. One percent of VAT revenues (15%).
3. GNP-linked contributions (60%).
4. Other revenues including previous year’s surplus (11%).

The traditional own means have existed almost right from the outset after the foundation of the European Economic Community in 1958, one of the EU’s three predecessors. The VAT source was introduced after all EU countries had adopted the VAT. However, this tends to be a regressive source and the search for a new source led to the introduction of a source based on the ability to pay, which was found in the form of a percentage of GNP. The introduction of this source mirrors the wish to come to a more equitable distribution of the EU’s financial burden. This mirrored the wish that richer countries would pay more into the EU budget.

The European Parliament fulfils a similar role in budgetary matters as most of the member states’ national parliaments. This modern role is diametrically opposed to the reason why parliaments have been created in the first place. This is quite similar as the reason for the USA’s independence: no taxation without representation. Parliaments gained budgetary rights to control the spending of wasteful kings. In modern times, however, parliaments exert upward pressure on public expenditure. There is a lobbying process in which pressure groups advocate their special interests. Elected politicians tend to be susceptible for these lobbies as they hope to gain political support by pleasing special interest groups. Moreover, the modern political culture considers ministers strong if they succeed in inflating their budgets. As a result, the only friend the taxpayer has in government is the finance minister, because usually it is the finance minister who is held accountable for the total tax burden.

The literature often addresses the European Union’s problem of a “democratic deficit” (Lodge, 1995). This not only refers to the initially very limited, but over time growing powers of the European Parliament. It also pertains to the low turn-out at elections for this parliament as this hurts the European Parliament’s mandate. European integration “was based on an essentially 'top-down' process in which the political (and business) elite, with good intentions, made the running” (Swann, 1996, p. 127). Or - as a leader in the British newspaper The Economist of March 2, 2002 puts it - any constitution written for the European Union in the past half-century, had it been honest, would have started with the words "We, the elites ...".

Transparency and accountability are not very well-developed in the EU. The literature often addresses a particular problem of the European Union as the “democratic deficit”. However, there is also another dimension that could be labeled as an “accountability deficit”. This paper addresses the accountability deficit and is organized as follows. Section 2 deals with legality and effectivity of EU expenditure. Section 3 describes recent developments in the field of accountability. One of these developments is the
emergence of annual member state declarations although this is still in an early stage. In 2008, only four EU member states issued a member state declaration. Section 4 details the Dutch member state declaration as an example of this new instrument to enhance accountability in the EU. Finally, section 5 concludes this paper.

2. Legality and Effectivity of EU Expenditure

The European Court of Auditors’ task is to investigate the legality and effectiveness of EU policies and to report on an annual basis. The Court has never issued an unqualified declaration of assurance (DAS) for the EU budget as a whole. Table 1 shows the development of the Court’s judgments in the period 1994-2008. From 2003 the Court presented a qualitative picture of all relevant policy groups in its annual reports. In 2006, the Court added some qualitative information, which it expanded somewhat further from 2007. As a result, the informational value of the Court’s annual reports has increased over time. However, a quantitative statement is still lacking.

In 2006, the European Commission drew up an action plan based on a review of gaps in the internal control systems (European Commission, 2006a). The goal was to further a positive statement of assurance by the European Court of Auditors. It started up 16 actions of which 13 have been finished, whereas three appeared to be infeasible or have been continued in another way. The Commission’s overall conclusion is positive even though the European Court of Auditors’ statement of legality was positive for no more than 45% of the budget expenditure in 2007. This compares with 6% in the Court’s declaration of assurance given for 2003 (European Commission, 2009e, p. 2). Another measure is the share of EU expenditure with an error rate of more than 5%. This share decreased to 31% in 2008 from 60% in 2005 (European Court of Auditors, 2009, p. 27). Although some progress can be observed, there is still plenty of room for improvement.

\[ DAS-\text{judgments European Court of Audit, 1994-2008} \]

<table>
<thead>
<tr>
<th>Year</th>
<th>General opinion</th>
<th>Qualitatively</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006-2008</td>
<td>Not positive</td>
<td>No qualitative judgment, but rough indication of percentage of errors per policy group.</td>
</tr>
<tr>
<td>2000-2005</td>
<td>Not positive</td>
<td>No qualitative judgment.</td>
</tr>
<tr>
<td>1999</td>
<td>Not positive</td>
<td>No qualitative judgment. Unacceptable number of errors.</td>
</tr>
<tr>
<td>1998</td>
<td>Not positive</td>
<td>No qualitative judgment. Percentage material errors the same as in previous years.</td>
</tr>
<tr>
<td>1997</td>
<td>Not positive</td>
<td>No qualitative judgment. Unacceptable number of material errors. Percentage errors the same as in previous years.</td>
</tr>
<tr>
<td>1996</td>
<td>Not positive</td>
<td>Material errors 5.4% of payments. Formal errors not quantified. No judgment possible for 4.3% of payments.</td>
</tr>
<tr>
<td>1995</td>
<td>Not positive</td>
<td>Material 5.9% errors. Formal errors not quantified. No judgment possible at 2.3% of payments.</td>
</tr>
<tr>
<td>1994</td>
<td>Not positive</td>
<td>Material errors 4% at payments. Formal errors 4.8%. No certainty for 14% of payments.</td>
</tr>
</tbody>
</table>

Source: Algemene Rekenkamer (2010), p. 36.
The Commission points to a number of actions that has led to progress. Examples include:

- The European Regional Development Fund (ERDF) and the European Social Fund (ESF), in particular the simplification of rules with a view to expand the use of flat rates, lump sums and unit costs to all types of expenditure.

- Agriculture, in particular the introduction of the Single Payment Scheme that has decoupled support from production and put an end to complex eligibility requirements.

One of the most important actions is action 10 (European Commission, 2006a, p. 8) pertaining to the need to reach an appropriate balance between the costs and benefits of controls, in particular for agricultural subsidies and structural fund flows, and the analysis of these funds coupled to the question which risk is acceptable. The European Court of Auditors has also presented statements on management and audit systems by policy group as Table 2 displays. [1] In addition, Table 2 shows the margins of errors that have been observed by policy group. In 2007, the Court considered the management and audit systems for three of the eight policy groups insufficient. In 2008, there was some improvement in that this number was down to two because the Court had observed improvements in the policy group Economic and financial affairs. Three policy groups show error margins of less than 2%. The biggest problem is the policy group Cohesion (the former structural funds) with an error margin of at least 11%.

Table 3 presents a summary of the findings with regard to the legality of EU expenditure in the period 2003-2008. The conclusion can be drawn that transparency is still limited although legality has improved. But there is still a long way to go to an unqualified statement of assurance.

Transparency with regard to effectiveness of expenditure is even lower. In addition to its synthesis report, the European Commission (2006a) published a communication about the policy results that had been achieved in 2005. In contrast to its title, however, the communication only presents information about policy initiatives that have been approved or will be developed. It does not present a review of the policy results that have been realized. The same holds true for the review of policy results achieved in 2006 (European Commission, 2007). This seems to mirror that politicians tend to be more interested in presenting plans for the future rather than giving account of policy results in the past.

The European Commission did not publish similar communications for the years 2007 and 2008. Thus, it seems that a process that at least potentially could have advanced the transparency of policy results has been terminated. In the absence of an overarching picture of the extent to which policy goals have been realized, there is only little insight in the realization of policy goals. In the rare cases where there is some insight the data suggest that policy goal realization is very limited. Admittedly, the European Commission does publish annual evaluation reviews. The review pertaining to 2008 (European Commission, 2009d) shows that 92 ex-post evaluations, 15 ex-ante evaluations, and 133 impact assessments have been carried out. However, the Commission does not present a synthesis of policy results by policy group and does not address policy effects.
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### European Court of Auditors’ judgments of management and audit systems and legality of transactions

**Table 2**

<table>
<thead>
<tr>
<th>Management and audit systems*</th>
<th>Errors at testing transactions*</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>2008</td>
</tr>
<tr>
<td>Own means</td>
<td>+</td>
</tr>
<tr>
<td>Agriculture and natural resources</td>
<td>0 0</td>
</tr>
<tr>
<td>Cohesion</td>
<td>0 0</td>
</tr>
<tr>
<td>Research, energy and transport</td>
<td>0 0</td>
</tr>
<tr>
<td>External aid, development and enlargement</td>
<td>0 0</td>
</tr>
<tr>
<td>Education and citizenship</td>
<td>0 0</td>
</tr>
<tr>
<td>Economic and financial affairs</td>
<td>+ 0</td>
</tr>
<tr>
<td>Administrative expenditure</td>
<td>+ +</td>
</tr>
</tbody>
</table>


a. + = sufficient; 0 = partly sufficient; - = insufficient.

b. + = below 2%; 0 = between 2% and 5%; - = above 5%.

### Legality of EU-policy

**Table 3**

<table>
<thead>
<tr>
<th>Source</th>
<th>Indicators (aggregate level)</th>
<th>Judgment Dutch Court of Audit on extent of insight in 2008*</th>
<th>Results in 2003-2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number and financial significance of reservations of DGs</td>
<td>Largely</td>
<td>Number of reservations decreased over time, quantitative insight in financial significance increased further. More reputational reservations.</td>
<td></td>
</tr>
<tr>
<td>Number and financial significance recorded irregularities</td>
<td>Largely</td>
<td>After adding information about internal policy and external measures in 2007 now also insight in 6 of the 7 policy groups. Number and financial European importance of irregularities fluctuates.</td>
<td></td>
</tr>
<tr>
<td>Commission Number and financial significance of corrections</td>
<td>Partly</td>
<td>Insight in 4 policy groups. Number and financial importance of irregularities fluctuates.</td>
<td></td>
</tr>
<tr>
<td>Number and financial significance of fraud reports</td>
<td>Largely</td>
<td>Number of cases increased over time. Financial importance of cases in 2008 unclear. Other information from OLAF partly for many years unclear.</td>
<td></td>
</tr>
<tr>
<td>European Court of Auditors General judgment regarding accounts</td>
<td>Partly</td>
<td>Largely no positive reliability statement (DAS); again no quantitative overview for 2008.</td>
<td></td>
</tr>
<tr>
<td>Judgment per policy group</td>
<td>Largely</td>
<td>From 2007 qualitative and partly quantitative picture per policy group. Percentage of errors mostly 2-5%. Natural Resources below 2% (for the first time in 2008), but Cohesion over 10% for 3rd consecutive year.</td>
<td></td>
</tr>
</tbody>
</table>


a. On the basis of an increasing scale: no, limited, partly, largely, full.
The European Commission uses the activity reports of its 21 policy directorates-general to give account of the policies pursued including the spending of EU funds in 2008. An analysis (Algemene Rekenkamer, 2010, pp. 27-35) of 15 directorates-general’s 2008 activity reports shows that they contain partial information about the legality of expenditures in the member states, but no information about the effectiveness of EU policies in the member states. The European Commission accepts in its synthesis report (European Commission, 2009b) the political responsibility for implementing the budget and for management by its directors-general. They all indicated reasonable assurance as to the adequate use of resources and on the fact that the implemented control procedures give the necessary guarantees concerning the legality and regularity of the underlying transactions. Some directors-general, however, disclosed residual weaknesses and made reservations in their annual activity reports, without calling into question the overall level of assurance given.

Fifteen reservations were made Commission-wide, which is somewhat lower than in 2007. In total, 12 directors-general expressed reservations in 2008 (13 in 2007) with three having two reservations each. Four reservations made in 2007 could be lifted. [2] The Commission aims at further improvement of shared management under its control, and to supporting the competent authorities in the member states. It also aims at improving the completeness and reliability of the reporting on recoveries, in particular as regards the data provided by the member states. If the Commission will be successful, the amount of assurance regarding legality of expenditures may increase further. However, this would require some clarification of the relationship between the synthesis report and the underlying annual activity reports.

3. Recent Developments Regarding Accountability

The European Commission has developed several instruments to further the member states accountability of EU funds they receive:

1. Contracts of confidence

The Commission describes a contract of confidence as an initiative that can assist in rendering controls effective throughout the programming period. It is a voluntary agreement between the European Commission and a member state (or a region) offering audit assurance of structural fund programs on an annual basis. Both the European Council and the European Parliament support these contracts. A condition for a contract is that the European Commission concurs with the operating management and control systems, the control strategy, and the quality of the annual audit report.

Seven member countries – Austria, Cyprus, Denmark, Estonia, Portugal, Slovenia and the UK – have concluded contracts of confidence with the European Commission for the period 2000-2006 with regard to the European Fund for Regional Development (EFRD) and the Cohesion Fund. In addition, two member states – Denmark and the UK – have concluded contracts of confidence regarding the European Social Fund.

The significance of these contracts is that the European Commission can be reasonably certain that the management and control systems comply with European legislation and that the audit strategy covers all audit activities in the programming period. As a result, the Commission can rely on national audit
authorities’ audits implying that the Commission needs less capacity to perform its own audits.

2. Annual summaries

Annual summaries present an overview of the reviews that have been carried out in the framework of financial management. From 2008, EU member states are mandated, under certain conditions, to submit annual summaries for money received from the agricultural and structural funds as well as the European Refugee Fund. So far, the European Commission has denied the European Parliament’s repeated requests to publish the annual summaries. The Commission confined itself to informing the European Parliament about the extent to which the member states have complied with the obligation to submit annual summaries and how the Commission has responded. Commissioner Kallas [3] supports publication of the annual summaries, but states that this requires the member states’ consent. Three member states (Finland, Netherlands and Sweden) have published their annual summaries on their own initiative.

The 2009 annual summaries pertain to agricultural subsidies, the structural funds, and the migration funds. As to the European Agricultural Guarantee Fund (EAGF) and the European Agricultural Fund for Rural Development (EAFRD) member states have to submit annual summaries only if they have two or more paying agencies that submit annual claims. This applies to 10 member states and all of them have submitted annual summaries to the European Commission. As to the structural funds all 27 member states have submitted annual summaries. However, some of them (Austria, Finland, Italy and Latvia) submitted annual summaries that did not comply with the European Commission’s minimum requirements. As to the European Refugee Fund all member states but one (Ireland) have submitted annual summaries. Notably, eight of them do not comply with the European Commission’s minimum requirements.

The European Parliament (2009) has solicited an external study of the first wave of annual summaries. The main conclusion is that annual summaries in their current form add little value compared to member states other accountability documents’ including member state declarations. The study suggests that annual summaries be developed toward more elaborate national member state declarations.

3. Member state declarations

A member state declaration of assurance is a statement on the member states' management and use of funds received from the EU. In such a declaration a member state’s government declares whether receipt and use of EU funds comply with EU legislation and whether control of financial transactions complies with the requirements. Only four member states issue a declaration: Denmark, the Netherlands, Sweden and the UK (Algemene Rekenkamer, 2010, pp. 54-57).

The Danish General Accounting Office considers the EU accounts in compliance with EU regulations and has issued a positive statement about legality and regularity of underlying transactions even though it has observed errors in the Danish transfers of own means to the EU.

HM Treasury has prepared consolidated statements on the use of EU funds in the UK in the period 2007-2008 (HM Treasury, 2009), while the British National Audit Office (NAO) has issued opinions about these statements. The NAO presents a qualified opinion about the reliability of the accounts due to inconsistencies in the UK government’s application of accounting principles. Moreover, it presents an unqualified opinion about the regularity of the underlying transactions. Thus, the British NAO concludes that the
use of revenues and expenditures has been consistent with the goals.

The Swedish government has included a declaration of assurance in the national annual financial report and states that the EU accounts’ summary is consistent with the Swedish reporting principles. The Swedish National Audit Office considers the Swedish member state declaration accurate and reliable.

4. The Dutch Member State Declaration

The Dutch government issues an annual member state declaration in order to improve management, accountability and control regarding the funds the Netherlands remits to and receives from the EU. The 2008 declaration considers the following European funds:
1. European Agricultural Guarantee Fund (EAGF);
2. European Agricultural Fund for Rural Development (EAFRD);
3. European Regional Development Fund (ERDF);
4. European Social Fund (ESF);
5. European Fisheries Fund (EFF).

However, no expenditure has been declared for the ERDF, ESF and EFF in 2008. Therefore, the 2008 declaration considers only the design of the management and control systems in place for these funds.

The declaration is based on several sub-declarations:
1. A sub-declaration by the Agriculture Ministry, which is involved in the Common Agricultural Policy (CAP). The CAP is implemented by means of two funds that finance both specific production schemes and income support schemes in the agricultural sector. To qualify for aid under these schemes, farmers must satisfy certain conditions regarding eligible products and activities and provide specific information on them. The Netherlands has implemented the aid schemes through two paying agencies and five delegated bodies. The paying agencies must account for their expenditures and receipts, while they must also issue a management statement. The audit department of the Agriculture Ministry certifies the accounts of actual expenditures and receipts and the statements of assurance. Finally, the audit reports are forwarded together with the annual declaration of aggregate expenditure to the European Commission.

2. Sub-declarations with regard to the structural funds. The minister responsible for each fund signs a sub-declaration.
   a. The Economics Ministry administers the ERDF of which the certification and audit functions are centralized as there is one central certifying authority and one central audit authority (the Finance Ministry’s National Audit Authority). The National Audit Authority (NAA) provides assurance on the reliability of the sub-declaration.
   b. The Social Affairs Ministry administers the ESF of which the certification and audit functions are also centralized. The NAA provides assurance on the reliability of the sub-declaration.
   c. The Agriculture Ministry administers the EFF (which is strictly speaking not a structural fund). The certification and audit functions are centralized. The ministry’s audit department provides assurance on the reliability of the sub-declaration.

So far, the scope of the assurance reports is confined to the description and design of management and control systems. The reason is that no expenditures have been declared due to the fact that the European Commission has not yet approved the system descriptions.
The procedure to issue the member state declaration can thus be summarized as follows:

* The minister responsible for a specific policy field issues a sub-declaration on the performance of the systems, the management and control mechanisms and the legality and regularity of underlying transactions.

* The sub-declaration is audited by the ministry’s audit department or the NAA. The audit department issues an assurance report, including an opinion on the reliability of the sub-declaration.

* The Finance Ministry merges the sub-declarations and carries out a plausibility test. After approval by the cabinet, the Finance minister issues the national declaration on behalf of the government.

The Dutch minister of finance requests the Dutch Court of Audit to give an opinion on the annual member state declaration. The audit objective is to issue an opinion on the soundness of the preparation of the Dutch member state declaration and of the assertions made. The Court of Audit’s opinion on the member state declaration 2008 considers three aspects (Algemene Rekenkamer 2009, pp 7-9):

1. The preparation of the member state declaration and the underlying sub-declarations with associated consolidation statement. The Court’s opinion is that the declaration 2008 was prepared in a sound manner.

2. The statement on the systems and measures in place to manage and control EU funds. The Court’s opinion is that it is sound with regard to the performance of the management and control systems and the measures in place for the EAGF and EAFRD in 2008.

3. The statement on the legality and regularity of financial transactions down to the level of the final beneficiary. The Court’s opinion is that it is sound although it makes a reservation with regard to cross-compliance. [4]

5. Concluding Remarks

The literature often addresses a particular problem of the European Union called the “democratic deficit”. However, there is also another dimension that could be labeled an “accountability deficit”. Obviously, transparency and accountability are not very well-developed in the EU. The European Court of Auditors has never been able to issue an unqualified positive opinion on the legality and regularity of the EU budget execution, although some progress can be observed. The share of EU expenditure with an error rate of more than 5% decreased to 31% in 2008 from 60% in 2005. However, expenditure in the policy group Cohesion shows an error rate of at least 11%.

The European Commission has developed several instruments to further the member states accountability of EU funds they receive: contracts of confidence, annual summaries and member state declarations. Seven member countries have concluded contracts of confidence with the European Commission. All member states have submitted annual summaries. And four member states issue member state declarations. The paper describes as an example how the Dutch government has issued a member state declaration.

So far, the (early) experience with member state declarations suggests this is a useful instrument to improve accountability in the EU. Therefore, the EU may consider a mandate for member states to issue more elaborate member state declarations.
References


Notes

[1] The Court’s division of the budget in policy groups differs somewhat from the EU’s new budget composition.
[2] Interestingly, the director-general lifted his reservation relating to the implementation of IACS in Greece as Commission audits confirmed that Greece had complied with its action plan (EC, 2009b, p. 8).
[4] This refers to conditions in the field of public health, animal health, plant health, the environment and animal welfare that farmers must comply with in order to qualify for full assistance.