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# THE COMPARISON BETWEEN THE BUDGET OF THE EUROPEAN UNION AND THE BUDGET OF IRAQ

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***Abstract***

*The EU budget accounts for about 1% of GNI (Gross National Income) across the 28 member states and total public spending in each country ranges between 35% and 58% of GDP. Total spending by the EU in 2014 across all 28 member states was €142 billion, or just over 1% of the Gross National Income (GNI) of the whole EU. Since, as we shall see, there are mechanisms to ensure that the EU budget balances, total revenues were €144 billion in that year. This is a relatively small component of public spending within the EU: across the whole EU, public spending was 48.2% of GDP in 2014, with a range from 34.8% of GDP in Lithuania to 58.3% in Finland.*

*Iraq's economy has been ravaged by conflict and insecurity, with the sustained slump in oil prices compounding these ongoing issues. Oil used to account for 95% of all government revenues. As a result, the country has spent the last few years wrestling to bring down a budget deficit that has repeatedly surpassed $20bn (more than 10% of GDP), with much of the available revenues sucked up by the war against Isis militants. The government is forecasting a deficit of $19bn for 2017. This article contains a comparison between EU budget and Iraq in order to overcome the economic imbalances in general and the budget deficit in particular, and show the role of the general budget policy in the treatment of the budget deficit more we have compared all aspects of the public budget policy between Iraq and the European Union, both in terms of the frameworks that govern or impact on the state budget or ways to finance the deficit in both.*

*Keywords:* **budget of the European Union, European Union, budget of Iraq**
***JEL Classification: G***

## Revenue of the EU budget

The EU has three main sources of revenue that are related to GNI based contributions, VAT based contributions and finally tariffs. Nearly three quarters comes

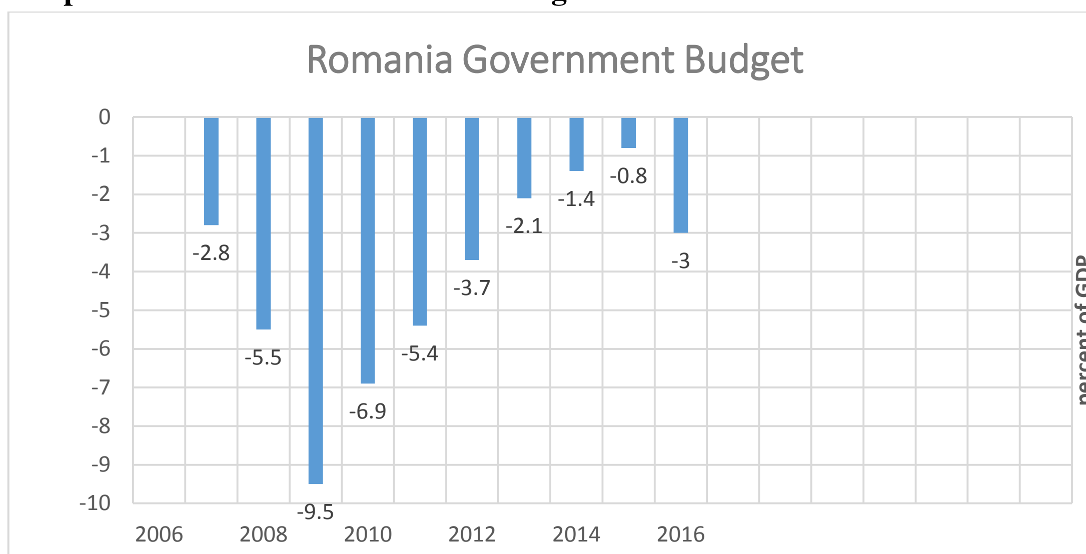
from GNI based contributions - that is countries contribute according to their Gross National Income. This is a relatively straightforward basis for making contributions. There are two riders to that. First, revisions to earlier estimates of GNI can lead to quite significant retrospective adjustments, as happened to the UK in 2014 when data adjustments led to a demand for an additional £1.7 billion (Browne et al., 2016).
Second, adjustments are made to payments as a result of negotiation. For example, over the current MFF period, Denmark, the Netherlands and Sweden have secured significant reductions in their GNI based contributions;

- About 13% of the EU budget comes from so called "VAT based contributions". This is effectively a contribution based on a harmonized measure of consumer spending and exists as a result of earlier hopes that VAT would become a union wide harmonized tax (Institute or Fiscal Studies, 2016). This makes little sense as a basis for contributions and is relatively harsh on those countries where consumer spending forms a large fraction of GDP. The share of VAT based contributions has been declining over time and ought to be ended altogether with the slack taken up by GNI based contributions (Browne e al., 2016);
- Finally tariffs - also known as traditional own resources - make up about 11% of the budget. They are duties levied on goods entering the EU. Since the EU is a customs union with no duties levied on within EU trade this is indeed a natural source of funding for the EU as a whole. It is perhaps odd that the countries where the duties are levied are entitled to keep 25% (falling to 20%) of the duties levied in recognition of "collection costs" when the average collection costs for taxes are a small fraction of this (Institute or Fiscal Studies, 2016).

**Romania Government Budget**

Romania recorded a Government Budget deficit equal to 3 percent of the country's Gross Domestic Product in 2016. Government Budget in Romania averaged -3.09 percent of GDP from 1993 until 2016, reaching an all-time high of 0.50 percent of GDP in 1993 and a record low of -9.50 percent of GDP in 2009 (Trading Economics, 2017).

**Graph no. 1 Romania Government Budget**




**Source: www.tradingeconomics.com**

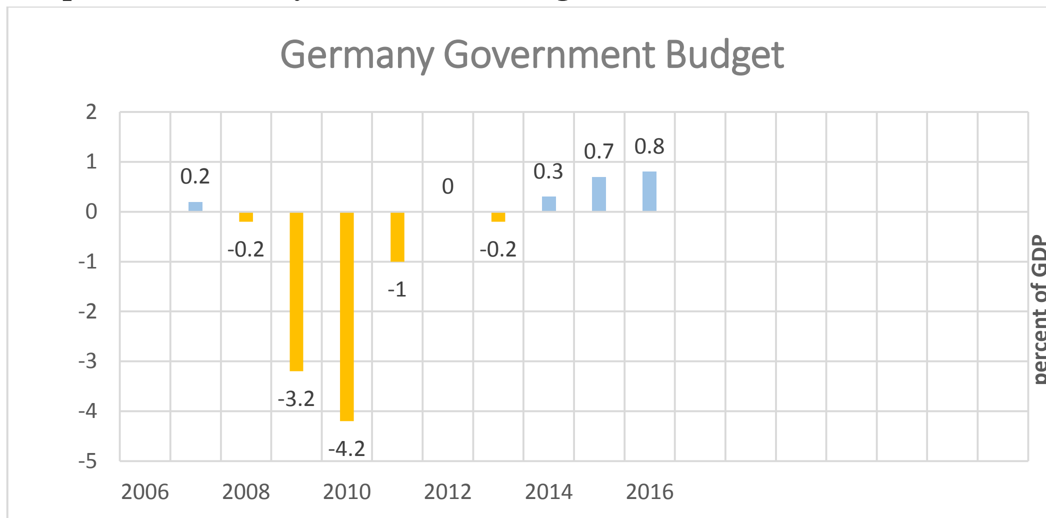
Government Budget is an itemized accounting of the payments received by government (taxes and other fees) and the payments made by government (purchases and transfer payments). A budget deficit occurs when a government spends more money than it takes in. The opposite of a budget deficit is a budget surplus.

**Germany Government Budget**

The German general government budget, which comprises central, state and local government and social security funds, recorded a net lending of €23.7 billion at the end of 2016, equivalent to 0.8 percent of GDP, compared with a preliminary figure of €19.2 billion, or 0.6 percent of GDP. In absolute terms, it was the biggest surplus recorded since German reunification, as revenues grew to €1,411.4 billion, due to a large increase in income tax and property tax payments (6.5 percent) and in social contributions (4.6 percent); while expenditures rose to €1,387.7 billion, driven by higher expenditure on intermediate consumption (8.7 percent) and a marked increase in expenditure on social benefits in kind: 6.2 percent (Institute or Fiscal Studies, 2016).

The largest surplus in 2016 was achieved by social insurance funds (€8.2 billion), followed by central government (€7.7 billion), state government (€4.7 billion) and local Government (€3.1 billion). Government Budget in Germany averaged -2.09 percent of GDP from 1995 until 2016, reaching an all-time high of 0.90 percent of GDP in 2000 and a record low of -9.40 percent of GDP in 1995.

**Graph no. 2 Germany Government Budget**

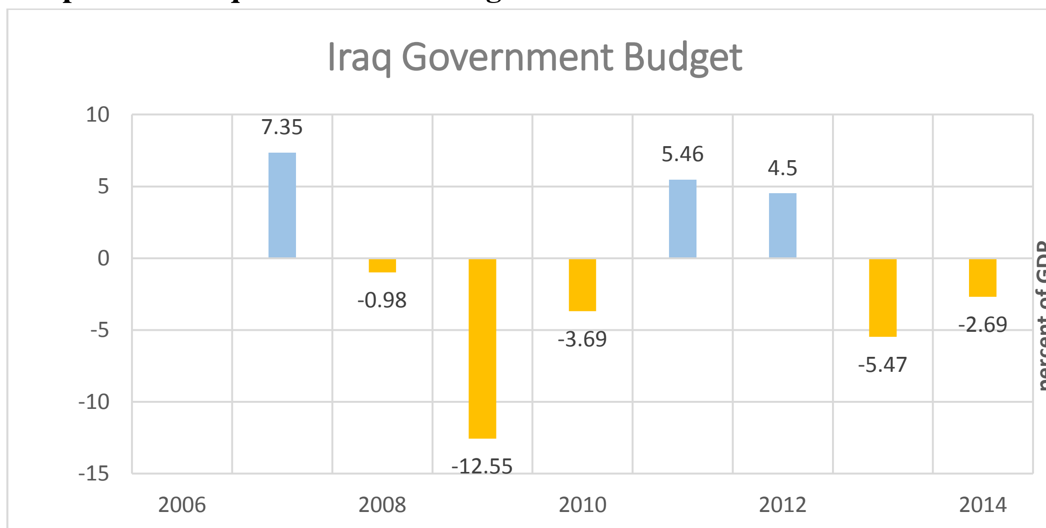



**Source: www.tradingeconomics.com**

## Iraq Government Budget

Iraq recorded a Government Budget deficit equal to 2.69 percent of the country's Gross Domestic Product in 2014. Government Budget in Iraq averaged -2.58 percent of GDP from 2004 until 2014, reaching an all-time high of 10.72 percent of GDP in 2006 and a record low of -34.91 percent of GDP in 2004 (Institute or Fiscal Studies. 2016).

**Graph no. 3 Iraq Government Budget**




**Source: www.tradingeconomics.com**

## Iraq's 2017 Federal Budget: Key features and trends

After a series of contentious debates that saw parliamentary blocs withdraw from the chamber over disagreements about revenue sharing, Iraq's Council of

Representatives eventually approved the 2017 federal budget on December 7 in the presence of 189 members (IMF, 2015).

The 2017 budget reduces government spending by about 5% compared to this year's budget. Total expenditure has been set at $85.2 billion (100.7 trillion dinars), with the government projecting total revenues to reach $67 billion, based on an average price of $42 per barrel and exports of 3.75 million bpd. The 2016 budget based its projections on 3.6 million bpd at an average of price of $45 per barrel. However, those targets have appeared to be hard to reach, with Basrah crude averaging $41 per barrel in the month of November and exports so far this year have averaged 3.28 million bpd. There is however some cause for optimism next year. November exports reached unprecedented levels with a combined total of 4.051 million bpd across Iraq and according to oil ministry officials, exports are expected to grow at a steady pace through 2017 (UNDP, 2014).

The revenue sharing agreement between Baghdad and Erbil has also remained unchanged within the text of the 2017 budget law. The Kurdistan Region is mandated to facilitate the export of 300,000 bpd from Kirkuk fields and a minimum of 250,000 bpd from fields within its own region. In return, the KRG will maintain their 17% share of national spending (minus deductions of sovereign expenses), despite a contentious debate within parliament over whether the KRG's share should be reduced to reflect the region's population. This dispute is reflected in Article 10 of the budget law, which states that the Kurdistan Region's share should be revised in 2018 after the results of a national census that is scheduled to be completed in 2017.

It is likely that the revenue sharing deal will remain only partially implemented, as was the case throughout 2016. Despite Article 29 of the bill stating that proceeds from any surplus exports from the Federal and Kurdish governments should go to the national treasury, the KRG will no doubt continue their independent exports. Reports suggest that the Ministry of Natural Resources is currently exporting independently around 580,000 bpd and Baghdad will likely reciprocate by paying only a portion of the 17% share to the KRG. Article 8(iv) of the budget law is clear that such allocations are proportional to any overall increases or decreases in generated revenues across the country. As a sign of things to come, as of September this year, Iraq has only earned 67% of projected revenue and executed 57% of expected spending.

The government's reduced spending plans for 2017 are also reflected in the 2017 deficit, which is projected at $18.4 billion, down from $20.4 billion in 2016's budget. That represents an important reduction, although a number of significant cuts have been made for the coming year, including a 60% slash in the construction and development projects fund for the regions and provinces, which is down from $1 billion this year to $423 million.

Non-oil revenues have remained stable at around $9.3 billion, equivalent to 14% of total revenues. The 2017 budget introduces some new items that represent a more concerted effort to reduce the financial burden of the public sector, encourage private

sector growth and strengthen non-oil streams of revenue. Specifically, these include (UNDP, 2014):

- The introduction of 4 years paid leave for public sector workers. Those who opt into this scheme will receive their full basic salary for four years without losing service that would count towards the retirement package. Additionally, government contractors who choose voluntary redundancy will be offered 3 months' salary for each year served. Similarly, Article 22 offers public sector employees who choose to transfer to the private sector half of their basic salary for two years.
- Imposition of a 3.8% income tax on all public sector workers. Revenues will go towards covering expenses of the Hashd al-Shaabi and supporting IDPs, while revenue collected from Kurdistan Region will go to the Peshmerga.
- Imposition of customs tariffs along all border crossings stipulating that revenue should return to the central government. Revenues from customs are expected to increase quite significantly over the next year, although provinces where the border crossings belong are entitled to keep half of the revenues, as per Article 56, on the condition that those funds are spent on rehabilitating the infrastructure for those crossings. Additionally, Article 23 introduces new tariffs on plane tickets (10,000 dinars on domestic flights and 25,000 dinars – or roughly $21 – on international flights), while the 20% sales tax on mobile phone cards remains unchanged.

With the investment budget equating to 25.3% of total spending (compared to 24.3% in 2016), the government is relying on $4.7 billion of foreign and domestic loans to support this endeavor. Among the budget's key investment priorities, the government has secured substantial foreign loans to invest in the country's power grid for 2017. These include loans from the Japan Bank for International Cooperation worth $50 million, the Islamic Development Bank worth $50 million and a Swedish loan of $500 million.

There is also a focus on infrastructure reconstruction, especially in towns that have been liberated from Daesh. Loans from the Japan Bank for International Cooperation worth $300m and the German KfW bank worth $190 million are particularly prominent.

The budget also reflects the recent passage of a bill that institutionalizes the Hashd al-Shaabi by stipulating in Article 52 the need to cover salaries for their members, in addition to reiterating that recruitment within the Hashd should be representative of communities where military operations have taken place. Furthermore, Article 50 states that salary payments dispersed to members of the Sahwa (Awakening) in Salahaddin, Anbar and other areas should run in parallel with a phasing out of the relevant department by the end of 2017 and the incorporation of Sahwa members into the Iraqi Security Forces and Hashd al-Shaabi (World Bank, 2016).

Overall, the version of the 2017 budget that parliament eventually approved offers some modest attempts to diversify revenue streams although it does little to mitigate the volatility of oil prices for the coming year. Iraq will need to continue to find ways to cut spending if it is to meet its commitments with the IMF. Two key areas to watch out for over the coming months will be the extent to which public sector employees opt to take the 4 years paid leave that is now on offer; in addition to the government's ability to effectively collect customs tariffs across the country.

## IMF Funds on Iraq

The war-torn country is currently working through a three-year $5.34bn program with the fund, with aims including restoring balance to the public finances, achieving debt sustainability and curbing corruption. Release of the $800m loan, which follows a $600m tranche released at the end of last year, is subject to the country passing an agreed supplementary budget for 2017 and strengthening spending controls (Rumney, 2017).

While an agreement, which also outlines objectives for the 2018 budget, has been reached between Iraqi authorities and IMF staff, the fund's executive board will need to give the deal final approval.

Christian Josz, IMF mission chief for Iraq, said the agreement will be put to the board "once prior actions have been implemented", possibly in August.

"Both the supplementary budget and the 2018 budget will keep fiscal consolidation, necessitated by the fall in oil prices, on track, while protecting social spending."

## Conclusions

In this article, we have seen that the EU Budget is rather complex and opaque. While there is a rational process in place to determine its size and allocation it is, perhaps inevitably, subject to considerable political horse trading. There are numerous special deals, allowances, rebates and the like negotiated within it. It is also difficult to reform, as shown by the fact that in many areas funds are allocated in line with previous allocations. This means that it is unlikely that revenues are spent on only the projects that will add the most value. That said, there are some attractive features to the budget process, in particular the efforts to plan for the long term through seven- year MFF periods while retaining the flexibility to respond to events through annual budgets. There may also be benefits of pooling certain spending where there are economies of scale or comparative advantages in different member states.

The revenue side of the EU Budget is relatively straightforward. Nearly three quarters comes from GNI based contributions - that is countries contribute according to their Gross National Income. This is a pretty straightforward and sensible basis for funding. Similarly, using tariffs that are applied to goods and services entering the EU

as a source of revenue for EU spending seems sensible: it would be unfair for those countries that are the point of entry for most goods to keep all this revenue when in many cases the final destination for these goods is elsewhere in the EU. However, the fact that countries which collect the tariffs get to keep 25% (falling to 20%) as costs of collection, seems less reasonable: the average cost of collecting taxes is, thankfully, a tiny fraction of this. Finally, about 13% of the EU budget comes from so called "VAT based contributions". These seem a less sensible basis for dividing the cost of EU spending between member states: the contributions bear only a passing relation to actual VAT revenues collected by member states as they based on a hypothetical harmonized VAT base that no member state actually applies, and disadvantage countries where spending on items that form part of this hypothetical construct forms a large fraction of GDP.

The spending side of the EU budget is dominated by two spending programs that between them account for over three quarters of the budget. Structural and cohesion funds on the one hand, and agriculture and rural development on the other, each account for about 38%, (or €54 billion in 2014), of total EU spending.

Cohesion funds go to the poorer EU nations - those with GNI per capita below 90% of the EU average. Structural funds go to regions within countries according to how poor they are relative to the EU average, but also according to levels of employment and population density. These funds ensure that the EU Budget redistributes from richer to poorer member states, though the extent of such redistribution is limited by their size: there is much more redistribution within member states between richer and poorer regions than occurs between EU member states.

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