Review of the Balance of Competences, EU Budget
Response by Dr Giacomo Benedetto, Department of Politics and International Relations, Royal Holloway, University of London, Egham, Surrey, TW20 0EX
Email: Giacomo.Benedetto@rhul.ac.uk

Role of institutions and budget system

Question 1: What do you see as the rationale for having an EU budget?

All international organisations need an internal administrative budget and this was what the EEC originally had in 1958. Soon after the Treaty of Rome, the European Social Fund and the Common Agricultural Policy (CAP) were established to provide limited redistribution within the Common Market. Beyond an internal administrative budget, the EU requires financing in order to support redistribution or investment in economic growth where this is either politically desirable or shown to be cost-effective (i.e. less costly than running separate national agricultural or social policies). In 1970, the CAP was entrenched with the creation of own resources (a permanent revenue system for the EEC). The rationale was to provide expenditure policies with a consolidated budget, which guaranteed consistency without the risk of national sabotage. Before 1970 the EEC depended on annual national contributions, which could be more easily withdrawn.

Ultimately there are three rationales for an entrenched budget. One is to provide redistribution to vulnerable sectors like agriculture or deprived regions that may otherwise oppose a de-regulated internal market in which they would be losers. Secondly, provision of European funds for those sectors could be more cost-effective than running 28 different national policies (though this would need verification). Thirdly, the budget also provides, particularly under Heading 1a, investment in research and development, technology, innovation, and infrastructure that makes the internal market more competitive. The latter would be investment that is not intended to provide traditional redistribution.

Question 2: What are your views on the appropriate role of national and European institutions, particularly the voting rules and relationship between domestic and European Parliaments, the Council and the Commission, in agreeing the EU budget?

The World Trade Organisation and NATO are international organisations run by governments. If the EU is going to be more than this, then it needs to have a budget that can be decided by its institutions though subject to national oversight.

The rules of the Lisbon Treaty (article 314) fix a version of co-decision for the EU's annual budget, whereby all budget lines need the agreement of both the European Parliament and a qualified majority in the Council. The timetable for agreeing the annual budget in October and November each year is extremely tight. No agreement does not mean a zero-budget. Instead, whichever is lowest out of either the European Commission's proposed budget or the previous year's budget takes effect (article 315) until and unless a new budget is agreed. This temporary default budget known as "provisional twelfths" can be increased by the Council unless the European Parliament blocks that increase. Further, the European Parliament may unilaterally cut spending in the temporary default budget, a power that the Council does not have. This creates a very strong bias for the status quo since failure to agree would normally result in continuity without cuts.

The powers over the annual budget need to be balanced with those over the multiannual financial framework (MFF), which sets the spending ceilings that the annual budgets cannot normally exceed. The MFF must be approved unanimously by the 28 national governments (article 312). The European Parliament has the power to propose the MFF and the power to block its approval. The EU's revenue (article 311) can only be changed through unanimity among the 28 Member State governments, subject to national parliamentary ratification and without the approval of the European Parliament.

We see that national parliaments have direct power only over changes to the EU's revenue – the pre-existing revenue continues unless there is unanimous ratification by the 28 national parliaments for a change. National governments exercise veto power over revenue and the MFF, while the European Parliament exercises veto power over the MFF and the annual budget. In deciding the EU's revenue, veto power is a very real power but may not enhance the scrutiny potential for the 28 national parliaments all of which have in-built pro-government majorities. It is easy for national parliaments or national governments to block decisions but less easy for them to propose or agenda-set EU policy when unanimous voting is required. For better or worse, cuts or increases, the removal of unanimous voting requirements for revenue or the MFF would make agreement on change easier to achieve.

If the objective is to enhance the control of national parliaments over the budget, increasing their power of audit would be useful and might be achievable if national parliaments adapted their own committee procedures. However, the primary budgetary role of national parliaments is to approve, amend or scrutinise national budgets.

Although the MFF and the EU's revenue are difficult to change, there are some alternatives. First, enhanced cooperation offers a way out for Member States wishing to set up new budgetary headings that do not affect those Member States that choose not to take part. Second, new rules allowing constructive abstention could also be considered. These would allow Member States objecting to budgetary proposals to abstain rather than to veto and to then exempt them from the decisions that were reached. In budgetary terms, this would mean neither contributing to nor benefitting from new items of expenditure that were agreed by the others.

Question 3: What are the advantages and disadvantages of having unanimously-agreed long-term budget periods? How long should they be?

There are two advantages to unanimously-agreed long-term budget periods. First, no MFF can be passed unless everyone agrees. This allows the UK but also every other Member State to try to enforce red lines. Second, the long-term MFF allows for long-term planning and, although conflictual, should limit that conflict so that it is not annual.

The main disadvantages include the risk of lowest-common-denominator agreements when unanimity is required. No agreement by the start of a new MFF period does not mean no budget. Instead, a roll-over of the previous MFF takes effect. Qualified majority voting would make it easier to reach agreements and although some governments and national parliaments would resist this, the UK is usually able to achieve most of what it wants in the context of qualified majorities necessary for agreeing annual budgets.

The MFF of 2014-2020 is for a period of seven years although the Lisbon Treaty foresees a minimum of five years. Adopting the next MFF for five years (2021-2025) would allow the EP and Commission that take office in 2019 one year to deliberate on a new budget and to propose it to European Council before the end of 2020. This would allow coincidence between the MFF and the terms of office of the EP and Commission increasing accountability. A short time period also means more frequent agreements (every five rather than seven years), which means the chance to vary EU spending more often according to need. A longer time period of seven years or even more reduces the MFF's politicisation and allows for longer-term planning.

Question 4: What are the advantages and disadvantages of the existing system of commitments and payments? Can you think of ways to improve that system?

Advantages:

This is unlike the budgeting system of most national governments and is unpopular with many of them. Paradoxically it delivers greater control over the budget by the governments than if spending were released straight away. Many headings in the EU budget require co-financing by national governments or other actors, which have to put up part of the money. Commitments are the amounts "committed" in principle by the EU, which are only fully delivered in "payments" if the recipient complies with all the conditions, attracts the right amount of co-financing and spends any advance correctly.

Disadvantages:

Because EU-financed projects are long-term, it can take several years before things move. If a recipient has met its obligations on the basis of "commitments", then payments have to be released subsequently. Unlike commitments, payments are real money and national governments can be reluctant to release the funds at the due time. Even if commitments are being reduced due to expenditure pressures, if recipients have met their obligations and payments are due, this leads to a temporary increase in spending to honour ex-ante legal commitments, and leading to the impression in the annual budgets of 2010-13 that spending was increasing. The system is complicated and difficult to understand, making it less accountable. One effect is the increase in the amount to liquidate (RAL or *reste à liquider*), which in every annual budget is the amount left over when payments are subtracted from commitments. The system has led to under-spends in payments, when budgeted payments could not all be released due to unfulfilled commitment obligations. In the annual budgets of 2011 to 2013, this created discord as to whether the under-spends could be shifted within the EU budget to cover other obligations where payments were insufficient.

Conclusion:

Audit methods could always be improved but the separation of commitments of payments is the only way to achieve accountability to national governments of spending in a supranational system. If EU spending is to occur at all, the UK government should agree with the principle of co-financing and release of funds only to those who have kept to the rules. This being the case, payments that follow commitments a few years later is the only method to use. The agreement for the MFF (2014-2020), however, allows some greater flexibility in use of under-spends in payments. Such funds can now be retained or shifted within the EU budget to cover unmet spending obligations. This avoids both a refund to Member States of unspent payments and the need for Member States to agree supplementary budgets to provide payments to other headings where there is a legal obligation to pay the bills.

Question 6: What are the advantages and disadvantages of having some expenditure, including to provide flexibility, held ‘off-budget’?

Advantages:

If the EU believes in providing a minimum level of solidarity between its members then a small slice ‘off-budget’ to allow flexibility is worth preserving. Traditionally, the European Development Fund and other aspects of the EU’ s foreign and security policies are held ‘off-budget’ or financed directly by Member States’ budgets despite being EU policies. While the EU’s development and foreign and security policies are real EU policies, their financing is more easily controlled by national governments and national parliaments.

Disadvantages:

The amounts held off-budget or rolled-over are still money and one may argue that the EU should not provide solidarity to Member States that face unexpected disasters. The provision of funds for running EU policies which are held outside the EU’s budget, such as development and aspects of foreign and security policy, may make matters more opaque.

Question 7: What are your views on the future structure of the EU budget and should the system change to reflect developments in the Euro Area? Should there be differentiated systems between Euro Area and non-Euro Area Member States, for example to allow fiscal transfers?

If the EU or Eurozone develop further competences in the future, there is a case for increasing the EU budget but most importantly, it should be asked what the budget is for. At present, its 2% of public spending is tiny, but has a big effect on agriculture and on economically deprived regions. These transfers should be retained if agricultural spending is shown to guarantee food supply and to be less costly than the alternative of having no CAP or a reduced version. For example, 28 national agricultural policies could be more costly than the EU-wide version. Allowing full scale national subsidy for agriculture could distort the internal market with respect to food supply. For more than a decade, there has been a call for the EU budget to invest in technology, innovation and other areas that promote economic growth under Heading 1a. The success of the Research Framework Programmes, or of TENs – now Connecting Europe – is evidence of this. Such spending can be justified if it can be shown that it leads to a collective benefit that is not directly redistributional like CAP or cohesion. However, this expenditure has only been increased at the price of reducing spending on CAP. Some Member States with potential to benefit from Heading 1a on ‘Competitiveness for Growth and Employment’, also have large agricultural sectors and are therefore hesitant about approving a switch in spending priority in the face of a powerful domestic lobby. Although unpopular, the solution is to increase the budget so that more can be invested in Heading 1a without penalising agriculture or cohesion.

EU budgetary expansion might be desirable within the Eurozone (or among the Eurozone’s future members such as Poland). Among the non-Eurozone members, it would be beneficial to identify which ones intend to join the Euro in the future. Future Eurozone members should be treated the same as pre-existing Eurozone members.

The traditional EU budget with its existing rules could continue and be made available to all EU Member States as at present. Meanwhile, a parallel budget for the Eurozone (and future Eurozone members) could be made available using enhanced cooperation. This could take charge of the European Stability Mechanism, and increase spending on cohesion (Heading 1b) and on innovation (Heading 1a) in Eurozone states up to whichever level its participating states agreed. The agreement to set up the parallel budget could be taken by a minimum of nine Member States with a fixed expiry date thus preventing "lock-in" of the kind that happened with the CAP in 1970. As the expiry date approaches, the participating Member States could agree for a renewal, while those who disagree could choose to withdraw. Only those Member States that agree to take part would contribute to the revenue of a Eurozone budget and would benefit from its expenditure.

General Value of Spend

Question 8: In your view, is the EU budget focused on areas of EU added value in expenditure?

I discuss Heading 1a in my answer to question 7 above. That heading includes investment in innovation, research and development, training, education, and Connecting Europe. These areas are considered to be added value because they provide collective benefits without being redistributional spending and at greater efficiency than providing those benefits through exclusively national policies. Under the MFF for 2014-2020, Heading 1a amounts to around 13% of EU spending, which is an increase on the past but below the level proposed by the European Commission in 2011.

The most recent financial figures published by the European Commission in the EU's financial report for the year 2012 show that the UK received only 5.49% of EU spending (€ 6933.9 million) but that it received 12.33% (or € 1268.9 million) of the spending earmarked for Competitiveness for Growth and Employment in Heading

1a. Within Heading 1a, the amount spent on the Research Framework Programme in the EU was € 6558.9 million, equivalent to 0.0508% of the EU's GNI or 5.8% of the EU's total revenue (not including traditional own resources). That expenditure within the UK sat at € 980 million, equivalent 0.0516% of the UK's GNI or 7.3% of the UK's total contribution to the EU budget. This is a significant area of EU expenditure, increased for the 2014-2020 MFF where the UK in absolute terms is a net recipient. Research and Development provide added value and is the area where the UK benefits the most. Besides direct money, the Research Frameworks contribute to the knowledge economy, in which the UK has leadership potential.[1]

The CAP and Cohesion Policy provide added value depending on one's political priorities. CAP guarantees food supply in Europe and if reduced or abolished would presumably require national level agricultural spending to replace it. "Re-nationalisation" of agriculture could be more costly than the status quo so in that respect CAP may provide added value. CAP and Cohesion also compensate economic sectors that may feel vulnerable to an unsubsidised internal market. If the continuation of CAP and Cohesion Policy provides redistribution that is desired and less costly than national-level redistribution, and if they facilitate the construction and maintenance of the internal market, then they represent added value.

Question 10: What is the right level for the EU budget?

This depends on what the EU is for and what the EU budget does. Even at present, it is very low at just 0.95% GNI in payments or around 2% of public spending. It is still money so what it does at present needs to be justified. Nevertheless, it is

[1] As an employee of Royal Holloway and Bedford New College, University of London, which holds contracts under the Framework Programmes, I declare an interest.

significantly less than that of other “federal” systems. Excluding Defence expenditure, federal spending in the USA and Switzerland was respectively 15% and 10% of GDP in 2012.

If investment in economic growth and innovation (under Heading 1a) is judged to be an important collective benefit then the budget for this is too low, particularly since the UK is a net recipient in the field of research and development. There is also a case for expanding cohesion under Heading 1b to compensate regions that are peripheral and inescapably less competitive economically if this stabilises the European economy – an indirect collective benefit for all if it provides greater confidence in the health of the internal market and the Eurozone. Expansion of the policy spending in Headings 1a and 1b could be achieved through a separate Eurozone budget (see my response to question 7).

Whether through the EU or through the Eurozone, increasing spending to at least half the level of the federal government in Switzerland, i.e. around 5% of GDP, would seem sensible to deliver the necessary redistribution and investments in innovation and growth. If this happens, it need not mean more overall public spending, but a transfer of expenditure from national to EU or Eurozone-level so that national spending would decrease concomitantly. This is desirable to stabilise the Eurozone and (in the interests of non-Eurozone members) to stabilise the internal market if such a transfer to EU level can be shown to be more cost-effective than national level spending.

The resource system

Question 12: What are your views on the current system whereby the EU budget is resourced on the basis that Member States contribute in relation to their income, with corrections where necessary?

From what I understand, the EU's revenue, up to the 0.95% of spending that is released in payments, is funded from three sources. The first two are external tariffs and a levy on VAT, which together make up around one-quarter of the revenue base. The rest is funded through a levy based on each Member State's GNI, so most of the revenue is based on ability to pay. If 1% of the UK's GNI is transferred then 1% of Bulgaria's GNI is also transferred. This seems fair and equal. However, because some Member States receive significantly more EU expenditure than others, large net contributors like the UK have received rebates on their "over-contributions". Although methods such as a Financial Transactions Tax or a change to the VAT levy have been proposed as a means to get away from the idea of net contributions, such alternatives would not solve the problem. Member states with a high number of financial transactions or VAT payments would still calculate that revenue as part of a net national contribution.

GNI percentage transfers are the fairest and most accountable source of revenue based on ability to pay. It is incumbent on national governments in wealthier Member States to explain that this is the very simple and accountable way for resourcing most of the EU budget. The UK pays more than Bulgaria only because its GDP per capita is so much higher.

As for rebates for net contributors, methods of calculation are complicated and unaccountable. The literature proposes five solutions to the current correction mechanisms, some of which also address the balance between redistribution and public goods:[2]

1. Straightforward lump sums or discounts based on percentage of GNI for net contributors as the European Commission has suggested; or
2. Separation of the EU budget into redistribution and administration (Headings 1b, 2 and 5) and investment in public goods (Headings 1a, 3a, 3b and 4) and to provide rebates only on over-contributions to redistribution and administration; or
3. A generalised correction mechanism. This would recognise the concept of 'Gross Value Added' in the CAP. The CAP benefits wealthier members and rewards productivity, so there is a case to separate it from rest of budget. Contributions to the CAP would rise in proportion to productivity, eliminating its redistributional effect. The CAP could also be co-financed by Member States reducing incentives to protect it; or
4. Recognition of pre-defined net balances of all Member States. Net contributors could then be compensated in a more transparent way. The EU could agree on the total amount of redistribution with net balances inversely correlated to income levels so that poorer states contribute less and receive more. Spending programmes would then take effect oblivious to contribution levels, followed by a correction mechanism to ensure the right net balance, which would compensate those who have over-contributed or under-received. Public goods (Heading 1a) and certain desirable aspects of redistribution

[2] Please see my review of this literature in Benedetto, G. (2012) 'Introduction: A History of the European Union Budget and the Possibilities for Reform', in Benedetto, G. and Milio, S. (eds) European Union Budget Reform: Institutions, Policy and Economic Crisis, Basingstoke: Palgrave.

under the Cohesion Policy (Heading 1b) could be excluded from the calculations of net balance, making agreement of net recipients more likely; or

5. A reverse correction mechanism would create a minimum floor rather than a maximum ceiling in revenue from Member States with GDP per capita above average. Wealthier Member States benefitting from the CAP would challenge spending to reduce their contribution. This could make investment in innovation, research and development, education, and Connecting Europe (Heading 1a) more attractive.