Evidence on the EU Budget for the Balance of Competences Review

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

When it comes to understanding the rationale for the EU budget, economists typically appeal to Musgrave's (1959) classic functions of government – allocation, stabilisation and redistribution – although these archetypes are of limited use when it comes to explaining how the Union actually organises its public finances. With respect to allocation, the fact that three-quarters of EU expenditure over the period 2014-2020 will go to cohesion and natural resources invites the question of whether the EU is truly satisfying public wants. As regards stabilisation, the Treaty's insistence that the EU budget be in balance clearly limits the scope for macroeconomic adjustment over the economic cycle.[2] On the issue of redistribution, finally, the evidence suggests that the EU budget does facilitate a transfer from richer to poorer member states (De la Fuente and Doménech, 2001). The size of this transfer is limited, however, by the own resources ceiling, which prohibits EU budgetary commitments in excess of 1.29% of gross national income.

From a political economy perspective, the rationale for the EU budget is inextricably linked to questions of independence and accountability. On the first of these points, the Treaty's insistence that the EU budget should be financed wholly from its own resources contrasts with the limited financial autonomy granted to international organisations – the United Nations' reliance on voluntary contributions from its members is a case in point – but it is consistent with the high degree of independence granted to EU bodies such as the European Commission. Be that as it may, the constraints placed on the overall size of the EU budget can be seen as a deliberate and generally successful attempt on the part of member states to hold EU bodies to account. A practical illustration of this financial accountability was seen with the creation of the European Financial Stabilisation Mechanism (EFSM) in May 2010, a crisis resolution mechanism over which the European Commission exercised a high degree of influence. Important though this ad-hoc instrument was for dealing with the euro area sovereign debt crisis, its size was limited to EUR 60 billion because of the maximum margin available under the EU's own resources ceiling. This sum was not nearly enough to provide a firewall for the euro area so member states replaced the EFSM with two off-budget instruments – the European Financial Stability Facility and the European Stability Mechanism – that involved the European Commission in their governance structures to a much more limited degree.

[1] The views expressed in this note are strictly personal and should not be attributed to Birkbeck College.
[2] Article 310 Treaty on the Functioning of the European Union (TFEU).

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

From a political economy perspective, the assignment of institutional roles in relation to the EU budget is subject to a common pool resource problem (Heinemann, Mohl and Osterloh, 2008). Simply put, this problem arises when policy makers consider the benefits of higher public expenditure but not the full costs of associated taxation. In the national context, this occurs when spending ministers push for resources for their own departments without regard for the overall tax burden. In the EU case, a similar problem arises because the European Parliament can (and generally does) seek higher EU expenditure without bearing responsibility for revenues, which come, in part, from member states in the form of the gross-national income own resource and from consumers from the value-added tax stream. Giving the European Parliament revenue raising powers could partially address this common pool resource problem. An alternative solution would be to reinforce member state control over revenue and expenditure decisions in relation to the EU budget so as to ensure that the political costs of higher budgetary commitments are internalised.

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

The practice of agreeing maximum annual amounts for different categories of EU expenditure for a period of no less than five years has pros and cons. An advantage is that it helps to avoid a repeat of the political crises that plagued negotiations over the Community budget in the 1970s and 1980s. A disadvantage is that it further blunts the effectiveness of the EU budget as a stabilisation mechanism, with the ceilings for the period 2007-2013, for instance, determined before the global financial crisis struck. The Multiannual Financial Framework for 2014-2020, it should be noted, introduces a greater degree of flexibility over such decisions, inter alia, by allowing expenditure on youth unemployment and research to be brought forward. Flexibility provisions such as this could be enhanced in future Multiannual Financial Frameworks, but as things stand the economic limitations of long budget periods are outweighed by the political benefits of long-term consensus over budget decisions.

The Council of Ministers adopts the regulation underpinning the Multiannual Financial Framework on the basis of a unanimous vote, although the Treaty allows the European Council to switch to qualified majority voting here if all heads of state or government agree.[3] The current practice has been widely criticised by economists for producing a system of 'juste retour' in which all member states must be seen to win from budget negotiations. The 2004 Sapir Report was sharply critical of unanimous voting here, which it saw as giving rise to 'different deals and attempts by governments to claw back in receipts as much of their contribution as possible' rather than 'a coherent set of measures aimed at pursuing EU objectives' (Sapir et al., 2004: 197). This argument has economic merits but a switch to qualified majority voting here would be politically unsustainable if it produced an EU budget deal that disadvantaged certain member states over the long-term. The political deadlock

[3] Article 312 TFEU

witnessed between 1979-1984 over the UK's comparatively large net contribution to the Community budget provides a salutary lesson in this regard.

What are your views on the current financial management system, in particular the discharge process, in ensuring EU budget funds are properly spent and audited?

Sound financial management is of paramount importance for ensuring trust in the governance of public money. Under the Treaty, it falls to the European Parliament, acting on the basis of a recommendation from the Council, to approve how the European Commission has implemented the EU budget in a given year.[4] According to this discharge process, the European Parliament and Council must examine a statement of assurance produced by the European Court of Auditors on 'the reliability of the [EU's] accounts and the legality and regularity of the underlying transactions'.[5] For nearly two decades now, the European Court of Auditors has consistently produced negative assessments, a situation that has undermined trust in how the EU manages public money. This lack of trust can be seen in the fact that almost three quarters of EU citizens consider there to be corruption within the EU institutions (Eurobarometer, 2012).

Although the European Court of Auditors' vigilance on financial management is welcome, its efforts to promote trust in the governance of the EU budget are not unproblematic. A key issue in this respect concerns the focus on error rates in the Court's annual statement of assurance. Error rates measure the various ways in which the implementation of the budget fails to comply with EU legislation. Although error rates are not a proxy for fraud this distinction tends to be lost in press coverage of European Court of Auditors' reports along with a clear sense of whether the responsibility for such mismanagement lies with EU institutions or member states or both. Reform options here range from raising the Court's threshold for acceptable error to a more decentralised approach to auditing public finances (Davies and Polverari, 2011). The latter could involve closer cooperation between the European Court of Auditors and national audit bodies in line with the Treaty.[6] More radical would be the creation of a new audit body for the EU with a more decentralised governance structure. Either way, the production of statements of assurance for individual member states would be a welcome move.

What are the arguments for and against increasing or decreasing the degree of national flexibility in spending money allocated to Member States under one part of the EU budget in other parts of the budget?

The case for greater flexibility at lower levels of government is a recurring issue in fiscal federations. Block grants have been in use in the United States, for example, since the 1960s as part of periodic moves to give states a greater say in how federal funds are spent. In the United Kingdom, the Barnett formula provides a block grant to Scotland, Wales and Northern Ireland for certain categories of public expenditure. In a review of the US experience, Finegold, Wherry and Schardin (2004) find that the real value of block grants tends to be eroded over time alongside the degree of

[4] Article 319 TFEU
[5] Article 287 TFEU
[6] Article 287 TFEU

flexibility offered by the federal government, but they suggest that such grants can improve efficiency where state administrative capacity is strong. In the United Kingdom, the Barnett formula has been criticised for allocating money to Scotland, Wales and Northern Ireland on the basis of population rather than need (Mackay and Williams, 2005) but it is integral to territorial politics in this country. Scotland, it is generally recognised, derives an ‘expenditure advantage’ from the block grant even if the workings of the Barnett formula mean that these benefits are likely to dissipate over time (Keating, 2009). Seen in these terms, there are economic and political arguments for giving the UK, with its well-developed system of administrative capacity, greater flexibility over how to spend EU funds. Whether other EU member states would agree to further concessions in this domain remains to be seen but a better budget deal could be a price worth paying for boosting the EU’s legitimacy in the eyes of the British people.

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