

# Balance of Competences – EU Budget

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## Initial Comments

The EU budget has been debated extensively and the positions of different protagonists in these debates have become deeply entrenched. As a result there are two risks inherent in any submission on this topic: first, that there is likely to be little new or surprising to be said; and, second, that any proposition which appeals to one side of a debate will be peremptorily dismissed by the other.

There is plenty of academic work, notably associated with the concept of fiscal federalism, which analyses how spending competences should be assigned in a multi-level governance system. However, it is hard to relate the EU budget to the conceptual models. For example, typical assignments to the highest level of governance, such as defence or macroeconomic stabilisation, are far from what is conceivable for the EU budget. Similarly, the proposition from second-generation fiscal federalism that incentives will be optimally aligned if each level of government is responsible for raising its own revenue is manifestly at odds with the practice in the EU.

The main explanation for these differences lie in the continuing ambiguity about what the EU is as a level of governance. It is manifestly not a federal government, akin to those of the US, Germany or other established federations. Yet it is also much more than an international organisation for which members belonging to it need only provide for the immediate administrative costs of running the organisation, and it is often apparent that citizens expect the EU to undertake tasks for which they are reluctant to grant it resources.

These and other distinctive features of the EU mean that the body of public finance theory offers little guidance in understanding the EU budget. They also mean that appeals to economic (or political) logic derived, however, loosely, from these theories in arguing for what should or should not be in the EU budget are unlikely to be successful. Put more bluntly, there is not going to be an easy answer to what constitutes added value from spending at the EU rather than another level of governance, nor a simple way of applying the principle of subsidiarity.

## Call for evidence questions

In the light of these observations, answers to the specific questions are now provided.

### Role of institutions and budget system

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

Three different rationales are intertwined. The first is what is in the Treaty which includes, notably the CAP and the Structural Funds, even though there is no clear mandate from the treaty about how large these funds should be. Second, there is a rationale based on the advantages of pooling resources to achieve economies of scale or of scope, or to achieve other sorts of external economies. Third, there has always been an element of political dealing in which lines of spending that favour particular interests (which could be groups of Member States) are included in the budget

even though the economic case for doing so is thin. In the limit, political dealing becomes *juste retour*, in which what matters above all is the net balances, rather than how the money from the EU budget is spent.

**2 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?**

It would be hard to devise a more cumbersome system to agree the EU budget, especially as it comprises barely 2% of aggregate public expenditure by all levels of government in the EU. This is less a matter of the respective roles of the institutions than of the lack of an effective means of arriving at a solution.

The fact that the European Parliament has a (potentially) strong say in how the budget is spent, but not in how the revenue is raised, is odd, although changing this would entail a new political settlement. It does mean that the incentives facing the EP in agreeing the budget are likely to favour higher spending, because it does not have to persuade voters to accept the resulting tax-burden.

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

The advantage of a medium term framework is that in a system in which so many actors have to be included in the agreements, at least the process need only be gone through every few years. The obvious drawback is that it then becomes hard to make changes in response to changing circumstances. Whether it should be five years, and thus coincide with the terms of office of the Commission and the European Parliament, or another duration, such as the present seven years, depends on the view taken on the EU as a level of government. Spending (and revenue-raising) plans normally form a key part of the electoral offer of parties, but (as noted above) this is not the case for the EP because the Council remains the dominant actor.

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

To a considerable extent, the commitments arise because of the need for a medium-term deal in which *juste retour* is a key factor. The scale of RAL (reste à liquider) is an evident problem, but the commitments/payments difficulties cannot be resolved without looking at the bigger picture of how the EU budget is negotiated and implemented.

**5 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?**

It has become an annual ritual that has little to do with the propriety of EU spending. Indeed, members of the Court of Auditors have stated that it is unlikely that the EU accounts will ever achieve an unqualified statement of assurance. The reason is that the assessment conflates errors (often explicable by the complexity of the EU Financial Regulation) with fraud in how it is perceived by the public and the media. If public spending by national governments were subjected to a similar style of scrutiny, it would almost always be found wanting. Moreover, the discharge process says too little about whether the spending was effective.

**6 What are the advantages and disadvantages of having some expenditure, including to provide flexibility, held 'off-budget'?**

Yet again, this is about how to construct multi-faceted deals. In principle, it ought to be avoided, but has regularly proved to be the expedient solution. A rather unfortunate conclusion may be that such devices are occasionally necessary to break a logjam.

**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?**

The various initiatives to construct 'genuine' economic and monetary union (GEMU) testify to the shortcomings in the governance framework for the euro, one of which is the absence of at least some top-down fiscal stabilisation capacity. In addition, the crisis has exposed other needs for financial support, such as in breaking the toxic links between bank and sovereign debt. There are, consequently, varied arguments for additional forms of fiscal capacity at the supranational level. However, it is disingenuous to argue that any differentiation would only be between the euro and the non-euro countries: many of the measures under discussion as part of GEMU are likely to involve non-participating Member States.

**General value of spend**

**8 In your view, is the EU budget focussed on areas of EU added value in expenditure?**

Only to a limited extent, but see the answer to q.1, above. A prior question, to which there is unlikely to be an easy or consensual answer, is how to agree on what constitutes added value.

**9 What modes of expenditure (e.g. bid-based expenditure, automated expenditure, loans, grants) in the budget represent the most effective use of EU funds?**

All have their place and can be argued to be effective in different circumstances, but a simple categorisation is unrealistic.

**10 What is the right level for the EU budget?**

There is no 'right' level, because it depends on what tasks it is decided to delegate to the EU level, and that is a political choice, rather than one which can be derived from economic theories. Various sorts of cases can be made within a rather large range, as has been demonstrated in a multitude of studies, going back to the MacDougall Report in 1977.

**11 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?**

If *juste retour* remains a crucial basis for the spending mix, then greater flexibility would be warranted. But if EU policies are the focus, then national allocations should not be as prominent a consideration and the EU level should decide.

**The resource system**

**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?**

Contributions that are roughly proportional to relative prosperity can be considered fair in one interpretation of what is equitable, but are obviously not progressive.

Corrections, on any reasonable view of multi-level governance, are a nonsense, but they reflect an inability to agree on what is a sensible package of expenditure. It should be seen as a political problem to be resolved by a fundamental rethinking of what the EU budget is for, rather than increasing resort to a range of corrections.

**13 Do you have any other points to raise relating to the EU budget system, not covered by the questions above?**

See initial comments.