Review of the Balance of Competences – EU Budget Report

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Introduction

This submission (broadly) follows the structure of the questions set out on page 26 of the Call for Evidence published by HM Treasury.

One aspect of the Balance of Competences Review (BoCR) that needs to be defined carefully is the notion of 'EU'. The 'EU' level of competence still involves member states, but their degree of individual policy autonomy is limited, compared with policy areas that are either independent of the EU entirely, or where the EU competence is designated as 'supporting'. That said, in the collective 'EU' context there remains scope for working with other member states to pursue national policy objectives. It is my personal opinion that the UK, under successive governments, has failed to recognise this point sufficiently and utilise unofficial channels of negotiation to optimise its national interests within the collective EU context. As a full member state, it is not 'us and them', only 'us'; we do not have a relationship 'with' the EU, but with other countries and institutions 'in' the EU.

Setting and Agreeing the Budget

The primary rationale for having an EU budget is to facilitate expenditures on common EU policies, collecting revenues (primarily from the member states) for this purpose. As such, in principle the EU Budget should be a manifestation of decisions taken elsewhere in terms of EU policies and processes, specifically those decisions taken regarding the nature and scale of expenditure-generating policies. Even if this were the case, the EU Budget would still have to respect fundamental rules laid down in the Treaty regarding the EU Budget, such that it must balance each year; that is, it cannot run a deficit.

It is my opinion, however, that there is one particular feature of the EU Budget process that has created enormous difficulties. Specifically, over time the EU Budget has become an EU policy in its own right, with countries preoccupied by gross and net contributions. As a result, the paradox arises that enormous political capital is expended on negotiating a policy which,

[1] Please include my name and affiliation when publishing this submission as part of the BoCR documentation.

in economic terms, is extremely small in scale and very limited in breadth. Moreover, rather than budget transfers arising out of negotiations over different policies, to an extent this has been reversed – broad budgetary parameters are determined first, then policies pulled, pushed and squeezed to fit this financial corset. Given that this has elevated a country's gross and net budget contributions to such an overblown status, the inevitable consequence has been that the structure of policies on which the EU Budget is spent changes very little. This is the easiest way to ensure the distribution of transfers across countries changes the least; and, therefore, minimises any country's potential budgetary 'loss' from a given policy change.

This casts a shadow over much of what I have to say in this submission. This also helps explain the considerable path dependency in EU budget spending (see, for example, Ackrill, 2005; Ackrill and Kay, 2006; Kay and Ackrill, 2007).

The EU is driven to a significant degree, still, by the member states; and this applies moreso in budgetary matters than most policy areas. Even with this reality, I believe the current balance of competences is about right. I think it is appropriate that the European Parliament (EP) has, in general, gained powers over time. That said, it must also be remembered that the EU is not a country. Therefore it is inappropriate to compare the powers of the EP over the EU Budget with the powers of budgetary determination of a national parliament. I suggest it would be more pertinent to see the Council of the European Union as the EU-level institution most similar to national parliaments, insofar as budgetary determination is concerned. I comment budgetary control later.

Negotiations over the last two Multiannual Financial Frameworks (MFFs), in 2005 and 2012, have demonstrated clearly the ongoing ability of like-minded member states – including the UK – working in tandem to impose their preferences on the negotiating process. In 2012, this was achieved despite this being the first MFF negotiated after the enactment of the Lisbon Treaty, which gave the EP greater say over the MFF. Overall, I see no *a priori* reason to change significantly the balance of competences between institutions at the 'EU' level.

I think the introduction of MFFs in 1988 brought considerable financial control to the EU budget. That said, it was not until the CAP reform of 1992 that agricultural policy instruments were agreed (principally via the partial replacement of price support with direct payments) to enable CAP spending to be controlled sufficiently to ensure that CAP spending could respect the figures set out in the MFFs. Furthermore, in the first two MFFs this new structure for longer-term planning enabled a significant rebalancing of spending between policy areas, notably increasing the absolute and relative importance of structural/cohesion policy (see, for example, Ackrill, 2000). Challenges have come since 1999, however because, since then, member states have ensured the growth in total EU spending has been modest. As a result, budget negotiations have moved from being a positive-sum game to a zero-sum game. More precisely, there are two overlapping zero-sum games – the distribution of EU budget transfers (in particular spending) between countries; and between policy areas. Given this, again, the fewer and smaller the changes made to spending by policy, the smaller the resulting changes in the distribution of EU Budget transfers between member states.

I do not believe the introduction of MFFs created this problem – I am certain that the same concerns would have arisen had there still been only an annual budget process, without the over-arching MFF framework. The upshot of the EU Budget effectively becoming an EU policy in its own right, however, is that spending by policy is to a degree pre-determined by MFF agreement; which, in turn, makes restructuring the EU Budget very difficult. Given the challenges to financial control prior to 1988, I believe the MFFs have been a very positive development. I do not believe that fundamental reform of the MFF structure would improve flexibility and facilitate the greater reallocation of spending between different EU policies.

I also believe the current seven-year cycle is appropriate. Whilst, increasingly, expenditure programming across more and more policies is coordinated with the MFF cycle, this has not prevented policy reforms being negotiated outside of that cycle – as seen with the CAP. What I am not in favour of is a five-year cycle aligned with either EP elections or European Commission terms of office. As noted earlier, it is wrong to compare the EP with national parliaments in terms of the powers of budgetary determination. As the process of elections, manifestos and policy commitments is so different with the EP, linking MFF and EP cycles would, arguably, require a much greater role for the EP in MFF determination. Otherwise there would be no point in such an alignment.

As for aligning the MFFs with Commissioners' terms of office, this could be very disruptive. A new Commission would take time to put together a proposal for a new MFF and get it agreed. It is most likely that agreement and implementation would be middle or end of that Commission's time in office. Thus there is no logic to aligning Commission and MFF cycles, because each Commission's policy orientation would be reflected more in the time in office of the following Commission than their own time in office.

There is also what I believe is a very important wider consideration to bear in mind. It is precisely because the Commission is not an elected body, with a mandate linked to budgets, policies and the desire or need to get re-elected, that it can take a longer term view of policy. This I consider to be a very important positive for the EU – bearing in mind also that, with an unelected Commission, member states and the EP still have the final say agreeing individual pieces of legislation. On example is in the sphere of energy and climate action, where policy options are being discussed through to 2020, 2030 and even 2050. This long-term perspective is, I believe, something that would be harder to achieve if MFF and Commission cycles were synchronised – not least because such a synchronisation could suggest closer alignment between a given Commission and the policies developed through their time in office. This could shorten a given Commission's time-horizon, rather than freeing them to discuss and promote policies that might not deliver payoffs for many years.

I think there is a lot of merit in the system of Payment and Commitment Appropriations (PA and CA, respectively). The EU Budget embraces both annual and multi-annual policy and expenditure decisions. The PA/CA nomenclature is familiar and serves its purpose well. There are issues of concern, such as expenditure control (especially with multi-annual project spending), but these are not a direct consequence of the PA/CA system.

Running the Budget

I think determining the 'right level' for the EU Budget is a nigh-on impossible task; one complicated by the shift in the 'status' of the EU Budget in political negotiations, to a policy in its own right. Thus starting from a metaphorical clean sheet, where we would look to see which policies should receive EU spending, and at what level, is a political non-starter. The level of EU spending has been fairly stable for some considerable time, as a result of extensive, repeated and difficult political negotiations. What we have might be a second-best, sub-optimal equilibrium, but it is an equilibrium of sorts, nonetheless.

That said, if we were to run a simple thought experiment on what a fully overhauled EU Budget might look like, one guiding principle would probably be EU value added. Research and development funding is one area which delivers this. There is much less agreement over value added in, for example, cohesion policy, multiple studies have shown that cohesion spending boosts economic development in Convergence Objective regions which, in turn, generates positive spillovers to the benefit of richer regions and countries. In this context, such EU spending does generate value added at the EU level. With the Common Agricultural Policy, as I am sure the BoCR submissions for the agriculture report will reflect, one concept that is often utilised is fairness (as it is too with cohesion policy – hence at least some cohesion expenditures going to even the richest regions and countries). Fairness is a nebulous concept, but it is seen in many areas of EU activity. As such, it is a policy goal or policy outcome that is hard to express in value added or value for money terms, but is no less important for the EU for that, being part of its political calculus. Even if it were, technically, feasible to reduce all EU Budget spending to a question of value added, or of value for money, to do so would be to disregard other, more philosophical, ideas behind the EU.

Turning to the control of EU Budget spending, much attention is paid to the annual reports of the Court of Auditors and the failure in the last 18 years to approve the accounts. The reality of the situation is, however, rather more complex. First, there is an inherent paradox, between limited expenditure on EU administration, and the ability of the 'EU' (*de facto*, the European Commission) to control spending effectively – especially bearing in mind that 80% of EU spending is enacted through the member states. The Court of Auditors has a role to play, but perhaps a separate, parallel, body is needed to oversee that 80% of EU spending. Looking at the management of EU Competition Policy, the European Competition Network might offer a possible starting-point for establishing a financial-control equivalent.

A further concern is that, under current rules, the EU Budget is being held much more strictly to account than national budgets – to the extent that it might be impossible for the EU Budget ever to be given a clean bill of health. Bearing in mind that (at least in the UK) the media pay far more attention each year to this than to any non-clearance of accounts from national government departmental spending, the result is a highly distorted picture of EU spending – in absolute terms and relative to national expenditure control.

On the other side of the budget, I think that whilst the current dominance of GNI-based revenues in total own resources is a step away from the principles underpinning 'own resources' as a concept, I believe there are positives as well. Notably, I believe this revenue stands up well when judged against the classical Canons of Taxation, something I elaborated on in my written evidence to House of Lords, 2007 (pages 1-5 of the Minutes of Evidence).

Amongst the proposals for the (now current) MFF, new 'proper' own resources were suggested. One argument for this was that their introduction would help move the EU Budget debate beyond its current standing as a separate policy, with a focus on national budget balances, towards a new emphasis on what the EU should be doing. I think that this view is naïve: just as with traditional own resources currently, the money will still come 'through' member states, even if it is not directly 'from' them. This focus on budget balances and the *juste retour* has, as I have argued repeatedly, distorted all discussion over the EU Budget.

This problem finds its ultimate expression in budgetary corrections, which are a political sop to member states who are obsessed with budget balances, rather than what EU Budget is spent on. They have no economic rationale at all. The situation regarding the UK rebate has got much worse in one key regard, since 2004 and the accession of ten poorer countries. At its peak, over 90% of the UKs rebate was paid for by countries with lower (purchasing power parity) GDP per capita than the UK. In recent years the economic crisis and resulting changes to countries' economic performance has seen this figure fall to a bit under 80% (purchasing power parity). This situation can only be justified in the context of an EU Budget debate that has been utterly taken over by the obsession over net balances.

In terms of any debate over value for money or value added, this obsession misses one simple but utterly fundamental truth – that any valuation of EU membership is so much more than EU Budget transfers. The focus on net budget balances pretends – wrongly – that this is not so. If the debate is to be so dominated by net budget balances rather than the policies funded, then the basis of judging value for money should change. Since net contributions to the EU Budget have taken on the status of a policy in its own right, their value should be determined as a club membership fee. Then, their value would have to be judged against the entirety of EU membership.

Spending the Budget

Some of the issues raised in the questions set out in the Call for Evidence are either beyond my areas of expertise, or have already been covered. On the issue of 'off-budget' items, I think this is being abused. Most notably, the EDF only remains off-budget because the member states decided, during previous MFF negotiations, that by bringing it on-budget, the size of the EU Budget would rise above their publicly-stated limit for EU spending. This is not about flexibility but about politicians not wanting to explain why 'the EU Budget' had suddenly got bigger than they said it would be. If there is uncertainty in spending to be accommodated, this can be done using the mechanism of margins in the MFF, for example.

Future Budgets

The literature on fiscal federalism identifies three broad types of spending – stabilisation, allocation and (re)distribution. EU policy spending include examples of the latter two, but not stabilisation. There is an extensive literature on fiscal federalism and the use of annual balanced budget rules, but a key theme is that macroeconomic policy management functions – stabilisation – are typically not assigned to budget tiers where balanced budget rules are applied (ie they are applied to sub-national budgets, not national budgets). Balanced budget rules are inimical because the stabilisation function requires that the budget balance rises and falls – including typically falling into deficit over part of the economic cycle (this would only be avoided if the average budget balance was, on average, in significant surplus).

As I have analysed elsewhere (Ackrill, 2003), the original report on fiscal federalism and the EU (the 1977 'MacDougall Report'), one paper distinguishes the highest from the broadest level of fiscal authority. In a national setting, they are the same. In the EU, however, whilst the EU level is the broadest, member states remain the highest level of fiscal authority. Thus the status of the EU Budget is much more closely aligned with sub-national (eg regional, state, Land, etc ., budgets) than with national budgets.

Moreover, with the EU Budget there is a second dimension to consider – its tiny size, relative to national budgets, when expressed as a percentage of national income. It has the resource capacity to impact on regional development, research, farming, etc., but is far too small to have a role helping to stabilise the EU macroeconomy.

The design flaws in EMU, as revealed by the global economic crisis and, in particular, the sovereign debt crisis, have resulted in agreement being reached on a raft of new fiscal policy measures, especially for countries in the euro area. The fact that the European Stability Mechanism has access to €500bn of funds, set against an annual EU Budget of something around €120bn, serves to emphasise the different scale required even for this very partial move towards EMU-level fiscal stabilisation. There is no guarantee that anything like half a trillion euros will be called upon – but that is partly the point: the stabilisation function needs to be able to accommodate that level of uncertainty.

I argued, in Ackrill, 2003, that the EU Budget was incompatible with any stabilisation function in EMU. Whilst I would change some things in that book chapter if writing it today, that point I would leave unchanged – but I would qualify it. The crisis has shown the extent to which EMU requires stronger fiscal coordination than originally agreed. As this is implemented – and as more EU countries join EMU – then the continued separation of the EU Budget from macroeconomic fiscal stabilisation will come under greater scrutiny. Even so, the situation where the EU Budget and the fiscal function of stabilisation converge is many years, probably decades, away. In terms of the current balance of competences, they should be perfectly adequate for some time yet.

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