Review of the Balance of Competences

Note of Academics seminar on the EU budget call for evidence
Friday 10 January 2014

Attendees

(Chair) Harold Freeman, Deputy Director European Union Institutions and Policy, HM Treasury
Professor Robert Ackrill, Nottingham Trent University
Professor Iain Begg, London School of Economics and Political Science
Dr Dionyssis G. Dimitrakopoulos, Birkbeck University of London
Dr Dermot Hodson, Birkbeck University of London
Dr Julie Smith, University of Cambridge
Fiona Wishlade, Director European Policies Research Centre, University of Strathclyde
HM Treasury

HM Treasury provided an overview of the Balance of Competences process and the EU budget reports. Attendees discussed three broad areas of the budget:

1. Setting and agreeing the budget
2. Spending the budget
3. Running the budget

The following points were made as part of this discussion, held under the Chatham House Rule:

1 Setting and agreeing the budget

Rationale for the EU budget
Members questioned the fundamental rationale for the budget, linking this question to the role of the EU more widely. The MacDougall Report of 1977 on the role of public finance at the then Community level was referenced by several members. However, members noted that comparisons with other federal systems were not always helpful – nor were comparisons with international organisations. Broadly, the EU budget was not seen as easily related to other international budget models. Before discussing the necessary or optimal size for the EU budget, or the right types of spend, an understanding of the aims of the Union and the budget, was required.

Some members noted that the EU budget was not intended to operate in the same way, or with the same objectives, as national budgets. In short, the EU is not a country – and therefore the EU budget does not have all of the economic roles that a national budget does. This also, to an extent, recognised the size of the EU budget, which was seen by some as too small to have a similar impact as a national budget, or a measurable economic impact. Others saw the budget as a 'motor of integration' in the EU, and noted that the existence of a budget was effectively mandated by the Treaties of the EU, particularly in areas such as the Common Agricultural Policy or Structural and Cohesion Funds. Members also noted that while it may be politically difficult to change the current budget, a modern day composition, beginning from scratch, would look different to the current set up.

'*Juste Retour*' and net positions

Some members argued that several Member States had focussed on the principle of *Juste Retour'*– seeking a perceived 'fair' return from the budget, rather than prioritising the achievement of common policies through the budget. To that end Member States are unlikely to leave budget negotiations having successfully achieved a focus on 'added value' spending; they enter with a 'baseline' and leave having achieved 'an accounting principle'. This was seen by several members to have undermined the negotiation process and, to an extent, to have undermined the budget overall. This particular focus on achieving *Juste Retour* was seen to have led to the correction mechanisms within the budget, discussed in more detail below.

Evolving Council dynamics

Some in the group suggested that as more Member States become net contributors (or less substantial net recipients from the budget), the political pressure to restrain the size of the budget would consequently increase. Indeed, this had been observed already in recent years, with significant slowing of the growth of the EU budget.

European Parliament responsibility on budget

Some members commented that the limited role of the European Parliament in raising revenue could have an adverse effect on UK Government interests. For example, were MEPs to need to campaign on the basis of increased EU taxes to fund an increasing budget, the political incentive to argue for budget restraint might be greater. Others noted that the link between the European Parliament and the budget could be solidified by synchronising MFF periods with European Parliament terms, though others noted that this would not be practically straightforward.

2 Running the Budget

Financial Management

The group discussed the current financial management system of the budget. Some members raised the possible misconception among some quarters that the EU institutions were solely responsible for errors in the budget, noting that approximately 80% of budget expenditure flows through Member States.

The group discussed alternatives, with suggestions for a greater role for the European Parliament Budget Committee as a scrutiny body, rather than a 'lobby' for increased spend. Members noted the network of auditor agencies within Member States (e.g. the National Audit Office in the UK), suggesting that greater cooperation between the European Court of Auditors and this network. Members also drew comparisons with the European Court of Justice and its continued dialogue with national courts.

Other members suggested that, if the European Court of Auditors felt that it was not possible to give unqualified approval to the EU budget, then the system itself could be flawed. The group also noted that particular focus on 'error' and the discharge process ran the risk that consideration of added value would be lost – there was no link between the ECA's reporting and added value in the budget, with the result that a budget with a low error rate might still not be a well-spent budget. There was also the suggestion that this process was an 'annual charade', an area where 'policy was creating its own politics'.

Contributions
The group discussed the existing system for funding the EU budget. Some members suggested that the system as it stands resulted in Member State contributions which broadly correlated with 'ability to pay', or wealth. Others suggested that the contribution as a percentage of Gross Domestic Product wasn't always so reflective of wealth. Again, the group suggested that the process for agreeing reform of Own Resources led to unwelcome incentives – the European Parliaments incentives were towards increasing expenditure, arguably because of limited institutional authority on the revenue side.

Correction mechanisms
Members discussed, and strongly criticised, corrections on the revenue side of the budget. Members argued that corrections were a symptom of the focus among Member States on '*Juste Retour'* through achieving a particular net position for net contributors. Corrections were seen as having no economic rationale at all and as an active barrier to progress in reforming the expenditure side of the budget. Members suggested that it was hard to envisage any other system in which such correction mechanisms would be considered appropriate. Some members, however, recognised the link between the UK's abatement and the distribution of spend between old 'rich' Member States and newer Member States.

3 Spending the Budget

Added Value
Members discussed the value of spend in different areas of the budget. The group noted, however, that perceptions of 'added value' in the budget required understanding of the overall aims. It was seen by some members as uncertain whether EU added value could be convincingly identified at all. Some Member States had, as previous sections note, become primarily concerned with achieving a

particular net balance, which was seen to result in compromise in negotiations on reforming the budget – and ultimately blocking necessary reform.

Some members argued that, were policymakers to start the EU budget again 'from scratch', the current shape would not be the result. The group broadly agreed that Research and Development expenditure, particularly in Heading 1A of the budget, was a substantial priority, with some members noting the basis of that expenditure on excellence, with relatively clear results. Others noted that the value of Pillar One of the Common Agricultural Policy (direct payments to farmers), as redistributive spend, was relatively difficult to find.

Member States benefit from receipts

The group noted that while some Member States concentrate on achieving a 'fair' net balance, it was often the case that receipts in other Member States would flow back through other channels. For example, a major project in a Member State would, through the EU budget, be shown as receipts for that Member State, though that project might be delivered by a private company in another country, and that country may be classified as a 'net contributor' to the budget.

Flexibility

Some members suggested that giving Member States greater flexibility to decide how to distribute expenditure could lead to greater focus on areas of local value and go some way towards making the EU more relevant and acceptable to citizens. Others argued that this could break the link between EU budget spend and common EU policies. The counter made to this point was that there is a significant difference between the renationalisation of EU spending and a 'menu' approach, where the common EU policy puts in place a series of policy options, with member states making their detailed choices on the basis of domestic preferences.

Euro Area Budget

Members briefly discussed the future direction of the EU budget, noting recent suggestions for a budget to focus on the Euro Area. Some members supported the theory, though argued that the Euro Area budget and EU budget should not combine. Others also noted that policy for the Euro Area budget was not yet clear and Member States outside the Euro Area might decide to take part.