The rationale for EU action: What are European Public Goods?

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Prepared for the BEPA Workshop on

'The political economy of EU public finances: designing governance for change'

5 February 2009

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[2] The author is writing here in a personal capacity. The author would like to thank Kaisa Korhonen (EPC) for background research on the budget review submissions and Sara Hagemann (EPC) and Alison Hunter (EPPC) for comments on an earlier draft. The author would also like to thank all the participants of the BEPA workshop for their helpful comments and suggestions, in particular Johannes Lindner who provided the response to this paper. All errors and omissions are the responsibility of the author.

Introduction

The Commission's budget review document stipulates that current policy drivers and future challenges should be at the centre of any future budget. The budget review aims "to see how the budget can already be shaped to serve EU policies and to meet the challenges of the decades ahead." (European Commission, 2007-08b) To achieve such a policy-driven EU budget, we must examine the rationale for expenditure at the EU level in more detail. Determining why EU spending might be necessary, from a political, economic, social or environmental standpoint, can give us a strong pointer on what policies should be funded at the EU level, and indeed what the broader future policy priorities of the EU should be.

A changing approach to EU policy?

It is important to recognise that such a policy-driven approach presupposes a particular underlying way of thinking about public spending. It represents a focus on the concrete outcomes of EU spending (most often measured according to utilitarian principles), rather than attaching most value to achieving further integration and coordination at the EU level. While this outcome-focused approach has become more common in recent years, it is a significant departure for EU policy. European integration has often been characterised by creating mechanisms for cooperation and coordination as a means for furthering integration, with the impact of policy only becoming apparent later down the line. A policy-driven budget, and in general a focus of EU policy on outcomes, should lead to more attention being paid to implementation and delivery, including the appraisal, monitoring and evaluation of policy outcomes. This requires a significant focus on the evidence-base of policy, including potential economic justifications for policy interventions.

While the Commission has put a policy-driven approach at the centre of the budget review, so far not all stakeholders have seriously attempted to apply this approach. There are many vested interests related to the EU budget and often willingness to reform in one area is outweighed by an insistence on the status quo in another. There is a status quo bias in the budget negotiation process and, unless the governance of the budget is addressed, significant progress is difficult. (see for example Zuleeg & Hagemann, 2008) This paper does not address the likelihood of reform but rather investigates how a policy-driven approach could be applied to the EU budget if reform were possible. While this might not be feasible in the short term, it should provide a pointer on how to take steps in this direction.

This paper firstly sketches out the broad EU framework and context in which the budget operates, including what might constitute a common European interest. The paper then examines the different rationales for EU policy, including political, social and environmental reasons. It then turns to the economic rationale, focusing specifically on European public goods and how the term, and related concepts of European added value and subsidiarity, has been used in the EU debate on future policy priorities. The paper contrasts these usages with how the economics discipline would define a public good and more broadly under what circumstances there is an economic justification for government action in relation to market failures. Finally, it examines what the underlying justifications for EU action there might be from an economic perspective. The paper notes some ways in which application of economic appraisal techniques could help the EU to set future policy priorities.

The budget in the wider EU context

Before examining the rationale for budgetary interventions in more detail, it is important to recognise that the budget is only one of a wide range of policy tools available at the EU-level and that it is relatively small in comparison to national budgets. EU integration usually focuses on legislative tools, within a broader context of a political negotiation process involving member states and the European institutions, as well as wider stakeholders. This can mean that the budget can end up being used to accommodate other interests rather than being the lead instrument to deliver a policy objective. Never-the-less, even under these circumstances, it is important to examine these interests in more detail to determine the rationale and objectives for EU-level intervention and spending.

The Common Interest

Action at EU level is often justified as being in the common interest of the EU member states. Delegating authority to a joint body to carry out a task which is of common interest is often termed a principal-agent relationship: The principals (member states) delegate authority (or pool sovereignty, to use the European term) to an agent (the Commission) to carry out actions to further their common interests[3] on their behalf. At EU level, this leads us back to the motivation for creating the European institutions. When governments identified a need to prevent future conflict by jointly managing crucial resources (coal and steel), they decided to delegate this task to the European level by creating the European institutions, initially through the High Authority of the European Coal and Steel Community.

Much of what the EU does can still be described by this relationship but there are inherent difficulties. The principal needs to set up the right incentive mechanisms for the agent to ensure that actions taken correspond to the common interests of the principals. In addition, at EU level, institutional relationships are more complex than a simple principal-agent relationship. The institutions have evolved, with co-legislators comprising both member states and directly elected representatives, with the ultimate authority coming from citizens. Although the principal-agent structure is still recognisable, at times the changes at EU level can make it difficult to determine what is being delegated and from whom to whom. It is becoming increasingly difficult to determine whose preferences and interests are, or should be, the driving force behind EU action.

Characterising the EU as a principal-agent relationship also does not help with identifying what a policy-driven budget should look like. Here, the common interest is a blanket term which could potentially cover any action at EU level. To draw up a policy-driven budget, we need to examine the rationale and motivation for spending in greater detail to determine what underlying objectives are being pursued.

[3] This might include political, economic, social and environmental interests, as explored later in this paper.

Rationales for EU action

Before turning to a more detailed examination of the potential economic rationale for EU spending, this paper will briefly sketch out other rationales which might underpin the EU budget. The later focus of this paper on the economic rationale does not imply that these rationales are in any way less important and in any examination of the EU budget, these should be taken into account.

Values and principles

Values and principles can be a motivation for EU action. European integration - 'an ever closer union among the peoples of Europe' (European Communities, 1957, Preamble) - can be a value in itself, based on the belief that European integration can overcome conflict and division. Barriers to EU integration, and a lack of cooperation and common action, stand in the way of achieving this goal.

While integration can be achieved through 'low politics' mechanisms (principally economic integration), here, realising economic benefits is not the final goal of EU policy and spending. Policy spillovers from low politics - knock-on effects leading to further integration in other areas - can be an underlying rationale for action in economic policy fields. If taking this point of view, economic objectives can be sacrificed for the greater good of further integration, potentially justifying, for example, the introduction of funding mechanisms to encourage more reluctant member states to integrate further.

Political interests

In common with all political systems, the EU's objectives might also reflect a range of different vested interests. This can include the economic, environmental or social interests of certain groups (for example, bureaucrats, farmers, environmental pressure groups or businesses) who are electorally powerful or have developed mechanisms to influence policy-making (e.g. lobbying). Vested interest of a wide range of actors can create inertia in the budget: once a policy with attached spending is created, any reform or change will be strongly opposed by those directly benefiting from it. [4]

Politicians might also pursue certain policies to gain re-election or to extend their political power. In recent years, the EU has become more 'political' with decision makers more closely tied into political processes, for example with the direct election of MEPs, which might have strengthened this rationale for EU spending. Decision-makers might also feel a tie to their national background, which could result in more money being channelled to their own nation or region.

'State' interests

In recent years, the argument has been made that individual member states lack critical mass politically, especially in foreign relations. The argument made is that the clout of the EU when acting together is greater than the sum of its parts. For example, in international trade negotiations the EU negotiates and acts as a single bloc, providing a powerful negotiation position.

[4] Binding 'elites' (decision-makers) into a European system can also be a way of furthering integration as it creates a situation where individual benefits are tied to European processes.

The cross-border nature of certain policy areas also makes it difficult for individual member states to act on their own. Combating international terrorism, dealing with organized crime, managing cross-border pollution, infectious diseases and natural disasters all require a degree of European and/or international coordination.

Environmental and social rationales

Finally, action might also be based on environmental and social objectives.[5] Reducing income disparity (between and within countries) by redistributing funds from richer to poorer member states and regions is already present at EU level: Cohesion policy is, in part, a transfer from richer parts of the EU to poorer ones, aiming to achieve higher growth in poorer regions. Overall, at European level, this transfer should increase 'utility' (the satisfaction or benefit derived from consumption) as poorer regions will gain more utility than the richer ones will sacrifice[6].

At European level, this argument is often couched in the term of 'solidarity', with the aim of ensuring that all parts of Europe develop economically. This argument has also been applied internationally to spending on international development aid. There is a clear redistribution element in these transfers, aiming for equity rather than economic efficiency.

Overlapping rationales

For many EU policies, a range of different rationales can be identified. Taking cohesion policy as an example, there are also economic reasons for this spending, as the interdependence of EU economies means that the stimulation of economic development in one area will have positive knock-on effects on others. Commissioner Hübner has also claimed in the past that the main aim of cohesion policy is to provide public goods: 'The aim of a modern cohesion policy is to provide 'public goods' aimed at improving skills, innovation capacity, entrepreneurship, sustainability, employment and accessibility, to enable all European territories to realise their full potential.' (Hübner, 2008) In addition, as noted above, the funding might also be seen as a 'sweetener' to drive forward further integration.

There are thus a range of different reasons for having EU policies and for spending money at EU level. Economic objectives, such as effectiveness and efficiency, are not the sole reason for EU action in many policy areas. However, economic objectives play a key role in many of these policy areas and in some areas the economic rationale is predominant. For example, investment in research is claimed to be justified as providing a European public good. The following sections will focus on this and similar economic justifications for action, determining whether and how they might be applied to EU policies.

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[5] The distinction between environmental, social and economic policies, or indeed between different types of economic policies such as fiscal, structural and supply side policies, is becoming more and more difficult to maintain. Many policies contain multiple objectives, for example retraining people to work in eco-industries, financed by fiscal stimulus money and channeled through the structural funds would be hard to classify in a specific policy category.

[6] Based on the marginal utility of consumption (the utility derived from consuming an additional unit) being higher for people on lower incomes.

The debate on European public goods

Back in 2003, the Sapir Report stated that: 'Since the 1980s, it [the EU] has increasingly taken on new responsibilities, either through extended competence (EMU) or as a result of a collective commitment vis-à-vis European public opinion by the heads of state and government (Lisbon). The scope of what are now explicitly or implicitly regarded as 'European public goods' has thus increased dramatically.' (Sapir, 2003)

EU public goods in the current budget review

In many submissions to the current budget review (European Commission, 2007-08a), there is a reference to the need to focus on EU policy priorities and, in particular, to advance and fund European public goods. For example, the Italian submission makes public goods central to what the EU should focus on: "As a general rule, the EU budget should favour the supply of "public goods", i.e. those goods whose benefits cannot be appropriated from would-be private investors and/or where the national scale may be inefficient. In this case, there is a risk of under-production of those goods, which leads to reduced productivity of the economy as a whole." (Government of Italy, 2008) The Finnish government submission notes that "If the EU budget is to generate the added value called for by the European Council, the structure of the budget must be revised to enable the Union to focus on supporting growth, competitiveness, expertise and innovations in policy areas where it is able to operate more effectively than the Member States, and to produce European level public goods, such as internal and external security and protection of the environment." (Government of Finland, 2008) In its submission the Scottish Government notes that 'There is certainly a strong case for public spending to be better focussed on specific schemes that can be shown to deliver public goods in line with the EU's own strategic priorities'. (Government of Scotland, 2008)

Examples of public goods cited by governments in budget review submissions include safety, external border control, high environmental standards (Government of Cyprus, 2008), environment, ecology, food safety standards, animal welfare, and rural development (in the context of the Common Agricultural Policy, CAP) (Government of Denmark, 2008), measures providing material and immaterial infrastructure and actions aiming at modernizing services and markets, in order to strengthen a particular Region's capacity to attract capital business and jobs, and improve citizens' quality of life (in the context of cohesion policy) (Government of Italy, 2008), Life+ and rural development policy (Government of Sweden, 2008), road, public transport, water treatment and the environment and public goods produced by farmers (Government of Ireland, 2008).

Some of the other contributions go even further. GKI Economic Research Co. claims that 'There are European public goods (such as the European Single Market, the Lisbon Strategy, energy, the environment, enlargement, Trans-European networks, etc.) that have to be funded at the level of the EU.' This contribution also notes a further range of policies which can be regarded as public goods, such as policies dealing with 'global challenges like climate change, energy supply and ageing' and regional challenges 'such as common border control along the external frontiers of the EU [and] the European neighbourhood policy aimed at ensuring stability in the regions adjacent to the EU'. (GKI Economic Research Co., 2008)

Most often, the 'public goods' term is used in the debate of the future of the CAP but, here, the usage of the term can differ significantly. Some argue that the CAP or elements of it are providing a public good while others cite the CAP as an example of a policy area which does not. Often, only certain elements of the CAP are highlighted as public goods.

A lack of definition

In general, these submissions lack clarity in setting out what exactly is meant by a European public good. Some of the contributions simply equate public benefits with public goods: 'In relation to both cohesion policy and the CAP, we believe there should be a stronger emphasis on payment in return for public benefits ('public goods') with measurable outcomes'. (Scottish Natural Heritage, 2008) This 'catch-all' usage of the term public goods distracts from the development of a genuine understanding and analysis of the role and importance of EU public goods, from an economic perspective.

In economics, public goods have a much more specific definition– they constitute one of a narrow set of so-called market failures where the state might need to intervene to correct the workings of the market to prevent a sub-optimal outcome[7], implying that government action can lead to an overall enhancement of economic efficiency.

Questioning what is or is not a European public good is not a matter of semantics: using this term implies that there is a specific underlying economic justification (in this case to achieve higher economic efficiency) for government action. Labelling policies as European public goods invokes an economic justification for action, implying that only through EU-level action can the benefits of a public good be delivered for member states or citizens. If these policies truly delivered public goods, it would be almost foolhardy not to provide them at European level.

An examination of public goods should be central to the budget review. As the Confederation of Swedish Enterprises puts it: 'Defining potential economies of scale and EU public goods is an important part of assessing the value added and should be one of the major tasks of the budget reform. Experience should be drawn from past budget allocation, measuring and following up objectives to see what areas have brought European value added, such as innovation projects and other policies that promote free movement across EU borders.' (Confederation of Swedish Enterprises, 2008)

The broad thrust of most definitions is that a European public good is one which can only be provided effectively at European level (if the resources were made available). The concept of European public goods is often used synonymously with the term EU added value, i.e. that there are certain policies where acting at the European level can add value over and above what could be done at the member state level. For example, the Hungarian Government submission to the budget review stipulates one criterion to recognise European value added is: "policies that produce European public goods (e.g. in

[7] A sub-optimal outcome in this context is an inefficient outcome which does not maximise economic benefits to society.

case of the CAP: food safety, landscape, safeguarding the rural communities, animal welfare, reducing air-pollution etc.)". (Government of Hungary, 2008)

Many descriptions of public goods at EU level also reflect the subsidiarity principle[8,] with the argument often invoking a kind of inverse subsidiarity, arguing that the EU level is the most appropriate level of dealing with a particular challenge. For example Antonio Martino, then Italian foreign minister, stated that: "It's wise to concentrate on the really big measures, what I call European public goods: Those goals that can be pursued only at European level." (International Herald Tribune, 1994)

In some instances, there also seems to be an implicit judgment that action at member state level has been inconsistent and/or ineffective and that a collective European response is now needed to correct member state failings.

While these issues are interrelated, they are not synonymous. In addition, they do not describe what an economist would understand as a public good and do not describe an economic rationale for action. The way economics approaches the economic rationale for policy action is explored in the next section.

What are market failures?

While the term European public good is used in a variety of different ways in the current debate, in economics has a very specific meaning. It is one of a small number of so-called market failures, where markets do not function effectively. Correcting market failures can be an economic rationale for government action.

Public goods

The economic definition of a public good is very strict: a public good is one which is non-rival, non-divisible and non-excludable. This means that the quantity consumed by one person does not affect how much someone else consumes. A strict public good is one where everyone consumes the same quantity. In addition, no one can be excluded from the consumption of a public good. As public goods can be consumed freely by anyone in society, they can lead to a free rider problem: in the absence of state provision, less is invested in or produced of the good in question, as no individual or firm will have the incentive to produce the public good for everyone else.

It is difficult to find many goods which fall under this strict definition. Most goods are divisable, rival and/or excludable. For example, road infrastructure can be excludable through toll roads and the usage of the roads will affect others through, for example, congestion. The kind of example of a public good which is often cited in associated literature includes the provision of defence at the national level, where 'safety' from invasion is enjoyed by everyone equally.

[8] Subsidiarity is the term which has been coined to describe that the EU should only perform those tasks which cannot be performed effectively at a lower level, for example within member states.

Common & club goods

But public goods are only one among a range of market failures in the economic literature, which would justify public intervention. Club goods are often confused with public goods but while they are non-rival, they are also excludable. This means that one individual's consumption does not affect anyone else's but that people are excluded from consumption if they do not belong to a particular 'club'. Examples include private parks or golf clubs.[9]

Common goods (or common-pool resources) are closely related: they are non-excludable but rivalrous. This means that everyone can access the good but their consumption affects the consumption of others, for example, water resources or the climate system. This can lead to the so-called 'tragedy of the commons', where a good freely available is overused, as individuals do not take account of the impact of their consumption on others.

Merit goods

Merit goods are also often confused with public goods. A merit good is one where one person's consumption of the good has a positive impact on others. For example, health and education not only benefits the individual but also reduce healthcare costs and improves competitiveness. In the absence of public intervention, too little is invested and consumed of such goods, meaning society as a whole loses out. There can also be free rider problems – why should an individual firm invest in training and skills of its workforce if someone else might poach their employees? Governments can intervene by incentivising investment or consumption of such goods or by supplying such goods at subsidised prices.

Externalities

Merit goods are a special case of a more general market failure: so-called externalities. This term refers to any good or service where some positive or negative aspect of its consumption is not taken into account in its price. An example of a negative externality is pollution, where the price system does not take account of the impact on society.

Coordination failures

Market failures can also arise from coordination failures. Coordination failures arise when different networks or technical systems are incompatible. This leads to an additional cost as well as restricting cross-border access to markets, limiting the overall size of the market and thus restricting gains from economies of scale and competition. Examples include the difference in track width between different national rail systems or different, incompatible computer operating systems.

In negotiations, countries or firms can also end up with a sub-optimal outcome if there is no way to enforce the agreement through a third party. If they cannot trust that the outcome will be enforced on

[9] But these will also become rivalrous if they are used above a certain threshold.

the other actors, they will not commit in the first place. This so-called prisoners' dilemma leads to a situation where - without intervention - all parties end up with an outcome which is less than optimal.

Market power and structure

Another set of market failures is related to the marketplace itself. If certain firms have excessive market power (for example monopolies or cartels), they can set a high price, reducing the quantity consumed and restricting consumer choice. This leads overall to a loss of benefits for society. But in certain circumstances monopolies can be the most cost-effective way of producing the good – if there are increasing returns to scale (i.e. each additional unit which is produced is cheaper to produce than the previous one), there can be a tendency towards a 'natural' monopoly. However, this in turn can lead to market power abuses.

Information failures

Finally, the incompleteness or unreliability of information can lead to market failure. For example, if consumers lack the information to make informed choices, they might end up with products which do not conform to their demand. This is aggravated if the situation is one where there is asymmetric information, i.e. if one party holds more information than another. This raises the problem of moral hazard, with one person being able to exploit their information advantage, leading to a sub-optimal outcome.

Necessary but not sufficient

If market failures are present, government intervention can often make society better off[10] by, for example, providing information to overcome information deficiencies, using competition policy to tackle uncompetitive practices and internalising the cost of externalities by making the polluter pay for emissions. However, the presence of market failure alone does not justify intervention. Governments also need to have the ability to intervene effectively. This can be difficult due to, for example, incomplete information or time lags between government action and results.

Government failure

Government action can also result in markets not operating efficiently. This can be a cost which is accepted as part of achieving another objective but it can also be an unintended consequence of action or a by-product of political processes. For example, the unnecessary imposition of compliance costs on businesses will reduce overall welfare. Differing legislative regimes, for example across borders, might also create additional compliance costs as well as incentivise the circumvention of costly rules.

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[10] In economic terms, an action which can improve the benefits someone receives without making anyone else worse off is referred to as 'Pareto efficiency'. To achieve this, an overall increase in benefits are required which can, if necessary, be redistributed to ensure no one is made worse off.

The economic rationale for European action

If we are intending to make the EU budget more policy-driven, EU spending needs to be examined to determine whether there is a genuine economic rationale – i.e. is this spending correcting a market failure. To do this, we need to take into account that at EU level, there are some additional elements to consider.

Coordination between governments

At EU-level, the public sector is not represented by a single government. Rather, the interaction between different member state governments and administrations provides another source of potential market failure, by creating cross-border policy coordination failures. Here, the coordination failure is between public bodies, such as governments, rather than businesses.

An example of such a coordination failure can be duplication. The elimination of such duplication is potentially a justification for European policy interventions. Carrying out actions at the EU level can potentially save money by, for example, replacing twenty-seven separate systems with one. Such cost effectiveness and efficiency arguments can also apply when effective cooperation across borders reduces the cost of public interventions – for example, cross-border healthcare has the potential to enable cost-effective specialisation and utilisation of capacity.

Without coordination at EU-level certain national policies might also not be effective: arguably, achieving macro-economic stability and dealing with economic and financial crises requires a coordinated approach, especially within the Euro-zone. Macroeconomic stability within the Euro-zone might even represent a club good.

The EU level is also able to prevent free riding and to enforce common agreements on all member states through the creation of supranational institutions. Economic integration can be a non-zero sum game, for example gains coming from increased specialisation and trade. But these gains might be unevenly distributed which might mean that there is a need to redistribute some of the gains from winners to losers. This might require having a mechanism such as the EU budget to credibly commit winners from integration to redistribute some of their gains.

Entrusting certain policies to a supranational institution might enable governments to credibly commit to policies, providing a higher degree of certainty for individual and firms, for example by committing to control inflation. Key examples here are the enforcement of the *acquis communautaire* through the European Court of Justice and monetary policy for the Euro-zone being conducted by the European Central Bank.

Cross-border

There is also a cross-border element, where markets might perform efficiently within one country but not across the EU due to barriers to the single market. The EU-level enables business activities of a sufficient scale and scope to reap the benefits of economies of scale. It can also provide public or research institutions of sufficient scale to act for large scale procurement or research activities, for example the European Organization for Nuclear Research (CERN). However, as the Sapir report noted: 'Half its [EU] spending goes on supporting a sector whose economic significance is declining, little is used to provide economic or non-economic public goods typically featuring large economies of scale.' Sapir, 2003)

At EU level, subsidiarity also needs to be taken into account, i.e. is the EU the right level for action? The Swedish Government's submission to the budget review notes that "National governments would thus be most apt to design and finance systems of support for public goods, except in cases where clear cross-border public goods can be identified. Risks of distortion in competition should be addressed through common regulation or co-ordination of action." (Government of Sweden, 2008)

When examining possible EU market failures, these differences when compared to the national level need to be kept in mind. They can provide an alternative economic rationale to action at the member state level and could thus be considered as being European-level market or government failures.

European public goods

When considering public goods, it is equally difficult to find public goods at EU level when compared to the national level which fall under the strict economic definition.[11] Andre Sapir identifies the following public goods: 'European public goods need to be financed at the EU level and there are a number of them out there. The first one, relates to the process of integration, … i.e. to the Single Market. … However, the public goods we think of today relate primarily to EU objectives, which are set at the European level. This would include the Lisbon Strategy, which was set in 2000 and is not only still with us today but has been very much renewed as a process. … The second public good is energy and the environment and again we can see in the discourse at the EU level that globalisation is always present, where energy and environment are key issues. I would also add a third public good. The Europe of today with its greater disparities is very different from the Europe of the past and it needs to function. This is in itself an objective and could therefore be viewed as a public good.' (Begg, I., Sapir, A. & Eriksson, J., 2008, p. 16)

Arguably, there are also some internal and external security policies which fall under the public good definition. For example, effectively controlling all EU borders might provide a public good for all EU citizens. The legal framework with effective protection of property rights, European democracy and the Internal Market might thus all be examples of European public goods but not all aspects of these policies might be non-rival, non-excludable and non-divisible. Many of these also depend on membership of the EU and thus they probably would be better characterised as club goods rather than public goods.

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[11] It has been argued that having unanimity rules will produce public goods at EU level as agreements will only be entered into if they are mutually beneficial, following on from the interpretation of K. Wicksell's work by writers such as J. Buchanan (see M. Johnson, 2005, for an examination of the interpretations of R. Musgrave and J. Buchanan of Wicksell's work). However, this reflects a different usage of the term public good, more akin to a non-zero-sum game. In addition, mutual benefits, here, might encompass non-economic gains. Within the current EU governance system, it could also be argued that Qualified Majority Voting on the financial frameworks and more flexibility could enable a move towards a more policy-driven budget.

Many other policy areas claimed to be European public goods do not conform to the strict economic definition. Begg notes that the EU is: "in practice, a delegated agency responsible for a very limited range of public finance tasks, nearly all concerned with what theory defines as allocation" (Begg, 2005, p. 6) rather than being concerned with the provision of public goods.

European market failures

Nevertheless there are possible economic justifications for intervention, including European market failures. Maintaining the competitive nature of the Single Market by controlling market power and ensuring consumer protection through the EU's competition and consumer protection policies can potentially prevent market failure. Within the Single Market, the EU can also potentially prevent moral hazard problems, where one agent holding more information than another can use this information to distort the market. Providing consumers with information and requiring disclosures of risks and accounts can be ways of dealing with this market failure.

Many have argued that tackling climate change, enhancing energy security and sustainable development are public goods: "The European Union (EU) should aim at providing European citizens with European public goods. … Sustainable development is the typical example of a European public good." (Fitoussi, J.-P. & Laurent, É., 2007, p.1) But the strict definition is hard to apply in this case. The impact of climate change and energy dependency differs significantly between different countries and groups in society. Similarly, the measures needed to tackle energy dependency and climate change impose different costs on different actors. While the overall benefits might outweigh the costs, they are not enjoyed equally in all countries and thus it is unlikely that this fulfils the conditions for a strict public good.

Rather than a public good, climate change and energy security might be more appropriately considered as potentially overcoming coordination failures as well as a prisoners' dilemma as countries could end up with sub-optimal outcomes in international negotiations due to a lack of commitment and enforcement mechanisms. Without EU-wide agreement there would be a free rider problem, with companies but also countries, able to benefit from actions in other countries without having to carry out costly actions themselves. In addition, the presence of cross-border impacts means that to deal with the negative externalities[12] arising from the emission of greenhouse gases (GHGs) cross-border cooperation is required. For example, the Emissions Trading Scheme (ETS), where companies have to buy permits to be allowed to emit GHGs, could not work on individual member state level, given the level of cross-border trade.

Other cross-border pollution, such as pollution carried by waterways might also require European action to address market failure. The joint management of common-pool resources, such as fish stocks, might also be necessary to prevent the 'tragedy of the commons'.

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[12] This could also be described as an example of the tragedy of the commons, where the free availability of the atmosphere as a sink for GHGs leads to overuse of the resource,

There are also a number of other potential coordination failures which can be addressed at the EU level. Coordination failures can arise when trying to deal with cross-border issues such as crime and in macroeconomic policy. Connecting networks across borders can create positive network externalities, for example in the field of transport or information and communication technology (ICT).

There might also be a range of merit goods, which can potentially be more effectively provided at EU level. Arguably, the investment in research and also cross-border education initiatives might be in this category. Social Europe might, beyond its social objectives, also encourage the creation of merit goods. However, it is necessary to not only determine that these are merit goods but also why the EU level might be best suited to deliver them. This might include the need for cross-border coordination or budget constraints in certain member states.

Added value of EU action?

More generally, the sharing of good practice across Europe might be a merit good in relation to public organisations, encouraging innovation and change. It can be argued that European Structural Funds in poorer regions of richer member states are also adding value beyond direct economic gains, by for example building partnership structures, encouraging policy innovation and cross-border partnership, as well as ensuring the visibility of the EU across all member states.

There is also the question of whether there is a rationale for EU-level action (even if there isn't a specific EU competence in a particular policy area) if action at member state level has been inconsistent and/or ineffective to deal with EU-wide challenges, for example in the modernisation of pension systems. However, failings at member state level are, by themselves, not a sufficient rationale for EU-level action. From an economic perspective, there might be a need to have EU-level action if cross-border issues are involved and/or if there is an agreed common policy approach, such as the Lisbon Agenda. In the absence of such EU-level rationales, member states remain accountable in their actions to their own electorates and if their policies do not deliver for their own citizens, it is national electorates which should hold them accountable.

However, the EU might have a role in providing incentives for member states to move in the right direction by highlighting good practice, conducting peer review and 'naming and shaming'. The Open Method of Coordination (OMC)[13] might serve such a role. This can potentially overcome information failures as well as providing member states with a commitment mechanism.

This section has highlighted that there are a number of potential economic rationales underpinning EU action, including EU market failures which EU policy might aim to correct. While there are few clearly identifiable European public goods, certain features such as cross-border issues and the involvement of a range of governments, means that there can be a strong underlying economic rationale for EU-level policy action.

[13] A definition of the Open Method of Coordination can be found on the Europa website

Policy implications

So what does all this mean for European policy? It could be argued that member states have agreed to pool sovereignty to address common challenges and that this is a sufficient rationale for EU-level action. There are a range of common European challenges on which there is a relatively broad level of agreement and these are the areas the EU should focus on. Tackling climate change and energy security, environmental degradation, dealing with ageing populations, remaining competitive in the global economy, exclusion from the labour market, internal and external security, dealing with the current economic and financial crisis, migration and social cohesion could all be seen as common European challenges.

Deciding on what policies are required to deal with these challenges requires a political decision to act at EU level. Even if economic gains are to be had, decision-makers might decide not to pursue a policy at EU level for political reasons. In the end, member states decide in how far they are willing to transfer powers and resources to the EU level.

The need to examine the economic rationale for action

But even if there was agreement on what common challenges Europe faces, not all European decision-makers necessarily share the same underlying objectives. For example, with migration, some countries might be more concerned with the challenge of integrating migrants whereas others want to attract more migrants for competitiveness reasons. Similarly, energy security for one country might focus on exploiting its own energy resources while another might see collective action against external suppliers as the way forward. While these objectives do not have to be mutually exclusive, at the very least they require a clear formulation of what policy goals are pursued collectively to address the common challenges.

Having common challenges and an agreement on whether to take action at EU-level thus does not remove the need to examine the underlying rationale for action, including economic motivations. In many cases, an economic argument underlies why a particular issue is identified as a common challenge in the first place. The use of economic justifications for action in the debate, for example claiming that EU action represents a public good, also requires a close examination of the evidence underpinning such a claim. Only if we are clear about the objectives which we are trying to achieve should we start to debate the specifics, for example what instruments are needed at EU-level and whether additional spending is required.

A need for appraisal of EU policies

To make the EU budget more policy-driven, we need to carry out a case-by-case appraisal of all broad policy areas to determine the underlying objectives. Such an appraisal of economic policies is common practice in some member states.[14] At EU level, there is now a requirement for impact assessments for

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[14] For example, in the UK the Green Book (HM Treasury, 2003) sets out guidance for appraisal and evaluation across government departments

new proposals but this does not yet take place broad policy areas, currently only focused on individual initiatives or directives. Having such an appraisal mechanism would clarify what objectives are being pursued and, in the case of an economic rationale, it would require an identification of market failures and how these will be addressed. It would also identify any trade-offs with other policy areas. Crucially, it also influences what policy responses are appropriate and at what level, for example, Eriksson stipulates that transnational public goods need to be supplied at a higher level. (see Begg, I., Sapir, A. & Eriksson, J., 2008, p. 11)

Such an assessment should include an appraisal of the competences, policy tools and mechanisms available to the EU. Having clear, shared policy objectives does not necessarily mean that the EU has the competences or instruments necessary to address the issue. Subsidiarity and proportionality[15] need to be respected. It might be best to address the issue at member state or regional level, following a common blueprint. Only if this does not work, might there be the need for EU-level action. In this case, it might be necessary to decide on the required competences and instruments at the European level if it is agreed that this is the right level to address the common challenge. Here, subsidiarity needs to cut both ways – if the EU level is the best level to address a certain issue, the powers and competences need to be transferred to match this common goal.

To be able to carry out such assessments will require the formulation of comprehensive guidance at EU level, detailing the different rationales for intervention as well as potential European market failures and potential policy tools to address them. A first application and testing of such guidance could be an analysis of the areas of EU competence as listed in the Lisbon Treaty (European Union, 2008) or of proposed measures in the successor to the Lisbon Agenda, to be conducted as part of the budget review. This would enable a building up of budget requirements from the bottom-up, rather than taking a top-down approach with financial constraints already in place.

This would also enable monitoring of the benefits of policies, which should be evaluated for what they have delivered in economic terms with a particular focus on EU added value, if the main objective, or indeed a secondary goal, is an economic one. This applies right from the micro-level, for example individual directives, to the assessment of whole policy fields.

Benefits of evidence-based policy

Undertaking such an assessment of the policy objectives, the underlying rationale (including potentially EU market failures) and of the instruments and tools at EU level would also provide clear direction from the principal to the agent, making it clear what objectives the EU institutions are tasked to pursue. It could free member states from attempting to micro-manage at EU level, instead focusing on the delivery of the agreed objectives. This might also produce more clarity of what is being achieved at EU level as in the past, 'The Union's legitimacy was weakened by its lack of visibility as regards the public goods it was supposed to provide, while national governments could claim responsibility for security, public order, health, education, social justice, and so on. Economic prosperity through the setting up of

[15] The institutions' involvement should be limited to what is necessary to achieve the objectives of the Treaties.

efficient market infrastructures, arguably a European public good, was too abstract to grasp the attention of public opinion.' (Sapir, 2003)

The analysis of the economic rationale together with an examination of the tools available at EU level might also highlight where there is a particular mismatch. It is, for example, difficult to see in what policy area the EU can truly provide EU public goods, given the limitations on its budget. However, if the aim is to encourage higher consumption of merit goods, EU policy tools and a relatively small budget can be used to incentivise and lever much greater change at member state level. Examining the underlying rationale can thus also provide crucial pointer of what action might be effective.

By having clarity about the underlying justification for the policy intervention, we might also be better able to identify those policies where the justification for intervention is weak. If no convincing political or economic justification for intervention can be found, it might be that such a policy does not have a strong argument for development or continuation. This might highlight areas where the underlying objective is to 'buy off' particular groups or countries. Such analysis might also show where the unintended consequences of a policy result in policy objectives being unmet or met incompletely. For example, if one of the underlying objectives of the Common Agricultural Policy is to provide poor farmers with income support, the data on the high proportion of funding which is paid out to larger-scale farmers is a powerful indicator that this aspect of policy might not be delivering.

The way forward

What we need at the European level is an agreement on long term challenges and what the shared policy objectives are for EU-level action. The EU is aiming to focus much more on delivery and implementation, which requires more clarity in terms of the underlying justification for EU action and, at least in areas where economic justifications are invoked, more evidence-based policy. The decision on what budget is needed should come thereafter and should be driven by what is required to deliver the agreed objective. 'In other words, we should establish the public goods and elements of redistribution that we want to see at the European level, add them up and accept that they represent so many per cent of the EU GDP.' (Begg, I., Sapir, A. & Eriksson, J., 2008, p. 18) This needs to include consideration of the consequences of no action. There is a need to determine what the opportunity cost is of maintaining the status quo and not taking action at EU level.

There are many challenges which can only be addressed at the EU level, but there is a need to use evidence to build a strong case and constituency for EU policy. Unfortunately, achieving such a policy-driven budget will be difficult within the current governance of the EU budget, which requires significant reform. (see Zuleeg & Hagemann, 2008) To ignite the debate of what the key challenges are and what should be done at EU level, more transparency of decisions and positions is required, with decision-makers needing to be accountable for their choices. At EU level, we need to focus on issues not processes, to be debated EU-wide with an informed audience, tied to EU political processes, for example the European Parliament elections. If we could move towards such an approach, it would not only strengthen the quality and delivery of EU policies; it would also provide a strong indication of what the European project should focus on in the years to come and provide more legitimacy for EU action.

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