

Public Finances in the EU

Conference organised by the
Bureau of European Policy Advisers of the European Commission
on 3-4 April 2008
in Brussels



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Martin Larch (editor)*



* *The views expressed in the document reflect the position of named individuals in the conference and do not necessarily reflect those of the European Commission*



Foreword

The budget review, initiated by the European Commission at the end of 2007 at the invitation of the European Parliament and the European Council, is a unique opportunity to examine the policy priorities of the European Union and to align the budget with those priorities. It is important to stress - and here I recall a thought repeatedly expressed by the President of the European Commission and also by Commissioner Grybauskaitė - that the budget review is about more than financial resources, as reflected in the EU budget; it is about a far-reaching vision for Europe.

The review must identify the main drivers of the changes that are facing the EU going forward. The challenges identified lead to policy options and policy priorities for the EU. Only then can the question of ‘how can the EU budget better serve the policy priorities?’ be answered successfully.

The first stage of the budget review is a public consultation process which calls upon all citizens and interested parties to express their views and expectations. The conference on Public Finances in the EU organised by my services on 3-4 April 2008 was part of this process. It brought together a large number of experts from academia, international organisations and policy institutions who, over the course of two days, discussed the scope and prospects for aligning the EU budget with policy priorities.

Commissioner Grybauskaitė set the overall tone of the conference, by outlining a vision of the future EU budget encompassing quality of spending, adequacy of resources and enhanced transparency, accountability and simplicity. The presentations and discussions at the conference addressed many of these issues and revealed a number of key concepts which are likely to shape the next stages, and possibly the outcome, of the budget review.



Vitor Gaspar

Bureau of European Policy Advisers

Executive Summary

The principal objective of the conference on *Public Finances in the EU* organised by the Bureau of European Policy Advisers (BEPA) of the European Commission on 3-4 April 2008 was to bring together a plurality of views from academia, international organisations and think tanks on how to better synchronise the EU budget with evolving policy challenges at EU level. The conference was part of the public consultation process that began on 12 September 2007 by which the Commission, following up on an agreement of the European Council in December 2005, launched the 2008/09 review of the EU budget.

Thanks to the high quality of the presentations of the invited speakers and the ensuing discussions, as well as the active involvement of a large number of the around 150 participants at the conference, the event was characterised by a frank, cordial and constructive exchange of views. A very broad range of alternative and, at times, conflicting positions on the EU budget was represented.

The juxtaposition of different angles and viewpoints brought to the fore a number of basic issues that are likely to play a role in the forthcoming debate on how to upgrade the EU budget. Some of these issues are ‘old acquaintances’; others have come to the fore more recently and hence attract more attention.

➤ *The Structure of the EU Budget and the Underlying Policy Priorities:* One common thread running through almost all the presentations and discussions was the view that the EU budget should be aligned with evolving policy challenges, such as the increase in global competition, climate change, migratory pressures and an ageing population, in order to enhance and safeguard its effectiveness as one of the main policy tools of the EU.

One specific point that was repeatedly highlighted in connection with the composition of current EU spending was that the provision of EU public goods, such as defence, security and R&D, or the provision of goods with economies of scale - typically investment in infrastructure - was under-represented. The obverse of the low share of public goods provision in the EU budget is the large portion of EU spending with distributive effects.

However, while there was a broad consensus among the participants that the current allocation of EU spending between distribution and public goods should be improved, it was also clear that designing and implementing a reallocation would be complicated by the fact there is no clear line of demarcation between the two areas. Discussions related to the various presentations at the conference made clear that it would be difficult to arrive at a consensus about what is distributive and what is a public good. It was felt that both dimensions would be relevant in a number of spending areas of the EU budget and that any measure or initiative aimed at re-adjusting

the composition of spending would have to live with this hybrid nature. One proposal advanced at the conference to circumvent the ‘indeterminacy’ was to put specific and clear policy objectives, such as regional or national income convergence, in the forefront rather than focusing attention on the distinction between distribution and allocation.

➤ *The Gravitational Force of the Status Quo:* The second issue cutting across the majority of the contributions discussed at the conference was the strength of the *status quo* bias. In contrast to the widespread conviction that understanding is part of the reform process, there was a distinct consensus among the participants that acknowledging the scope for improvement in the current EU budget is not sufficient to kick-start a successful therapy. There was a widely shared view that the *status quo* bias represents a sort of anomaly with respect to conventional economic thinking, in the sense that policy makers prefer to maintain policy arrangements agreed in the past for which they would most likely be prepared to pay much less if they were to put them in place today. Perceived losses seem to loom much larger than gains foregone.

One of the several reasons explaining the strength of the *status quo* bias that was highlighted at the conference was the very nature of reform processes. Reforms generally involve a degree of ex-ante uncertainty about the benefits from and costs of change. Similarly, reforms can give rise to effects which have the character of public goods, i.e. they also bring benefits to those who do not participate.

➤ *Views on How to Overcome the Status Quo Bias:* One possible way mentioned repeatedly at the conference to confront the *status quo* bias would be to improve the governance of both the implementation and the formation stages of the EU budget. Starting with the implementation of the budget, one element that came up more than once in the discussions and in the policy panel was the importance of a comprehensive assessment cycle of policies. Many participants concurred that, on top of the current arrangements, there was a need for setting up or improving an appraisal system that covers both the ex-ante and ex-post evaluation of EU spending so as to better establish its effectiveness relative to the reported goals and possibly draw conclusions for subsequent budgets. In this context, a number of experts argued that the likely impact of such a comprehensive appraisal system would be enhanced if the task were assigned to an independent agency.

As regards the formation stage of the EU budget, there was one arrangement that attracted particular attention among the participants. A number of speakers suggested designing the negotiation process in such a way as to clearly separate redistributive issues related to national net balance positions from specific EU policy priorities.

➤ *Stepping Up the Institutional Arrangements:* A further set of explanations for the *status quo* bias put forward at the conference are rooted in the current institutional set-up of the EU. In particular, several academics considered the requirement of unanimity in order to adopt the multiannual financial framework as a roadblock to change and reform. The ‘passerelle’ provision of the Lisbon Treaty, according to which the Council could decide unanimously to take future decisions on the budget by majority vote, was interpreted as an opportunity.

A second institutional issue was the duality of the allocation of responsibilities between the legislative function of the EU in general on the one hand (shared by the Council and the Parliament) and the adoption of the multiannual financial framework (essentially in the hands of the Council) on the other.

Turning to more operational issues, some speakers pointed to the possibility, not yet exploited fully in the current set-up, of setting a clear expiry date for expenditure policies. It was argued that, in the absence of a comprehensive assessment cycle that feeds back into the formation of budget if ineffectiveness is proved, such ‘sunset’ clauses would be a useful way to improve the budget’s capacity to adjust.

➤ *The EU Budget / Primus inter pares?:* While most participants agreed that the EU budget is an important instrument of EU policy making, there was also an understanding among a number of speakers and discussants that it was not the only and probably not even the most important tool in the hands of EU policy makers. Against this backdrop, the point was made that attention should not only be confined to the composition or the size of the budget. The question of which policy objectives could be achieved by which means - money or regulation - was felt to be equally important. Valid arguments were put forward suggesting that a number of EU policy challenges should be addressed by improving the regulatory framework rather than by transferring money across Member States.

➤ *Communicating Change:* The exchange of views and proposals at the conference on how to review the EU budget made clear that, in the recent past, the Council and the Commission had already undertaken some of the steps ‘prescribed’ by the experts from academia. Specifically, attention was drawn to the existing efforts to exploit synergies across policy processes (e.g. Lisbon and fiscal surveillance) or to improve the assessment cycle of EU policies. However, there was agreement that, for reasons that need to be better understood, such efforts have not yet made their way into the public domain.



Conference Programme

DAY 1: Thursday, 3 April 2008

08:30-09:00 Registration

09:00-09:15 Opening remarks Commissioner Grybauskaitė

Session 1: Growth, Transparency and Reform

Chair: Antonio Cabral (EU Commission)

09:15- 09:35 **Keynote Speaker:** P. Aghion (Harvard University) – Innovation and Budgetary Policy over the Cycle

09:35-09:55 Discussant R. Marimon (EUI, Florence)

09:55-10:35 General discussion

11:05-11:25 M. De Broeck and R. Hemming (International Monetary Fund) – The Transparency of the EU Budget

11:25-11:45 S. Osterloh, P. Mohl and F. Heinemann (ZEW, Mannheim) – EU Budget Reform Options and the Common Pool Problem

11:45-12:05 Discussant L. Heikensten (Court of Auditors)

12:05-12:45 General discussion

Session 2: Redistribution, Regional Policy and Agricultural Policy

Chair: Stefan Lehner (EU Commission)

A. Regional Policy

14:00-14:20 **Keynote Speaker:** C. Fuest (University of Koln) – EU Regional Policy and Tax Competition (Becker and Fuest)

14:20-14:40 Discussant S. Kalemli-Ozcan (University of Houston, ECB and NBER)

B. Agricultural Policy

14:40-15:00 C. Moreddu (OECD) – Agricultural Policy Developments in the European Union

15:00-15:20 Discussant A. Swinbank (University of Reading)

15:20-16:00 General discussion

C. National Interests and Redistribution

- 16:30-16:50 M. Mrak and V. Rant (University of Ljubljana) – Financial Perspectives 2007-2013: Domination of National Interests
- 16:50-17:10 A. De la Fuente (Instituto de Análisis Económico, CSIC), R. Doménech (Oficina Económica del Presidente and Universidad de Valencia) and V. Rant (University of Ljubljana) – Addressing the *Net Balances* Problem as a Prerequisite for EU Budget Reform: A Proposal
- 17:10-17:30 Discussant L. Schuknecht (ECB)
- 17:30-18:10 General discussion

DAY 2: Friday, 4 April 2008

Session 3: The Political Economy of the EU Public Finances

Chair: Marco Buti (EU Commission)

- 08:30-08:50 **Keynote Speaker:** M. A. Pollack (Temple University) – Member State Principals, Supranational Agents, and the EU Budgetary Process, 1970-2008
- 08:50-09:10 Discussant J. Lindner (ECB)
- 09:10-09:50 General discussion
- 09:50-10:10 F. Heinemann, P. Mohl and S. Osterloh (ZEW, Mannheim) – Who Is Afraid of an EU Tax and Why: Determinants of Tax Preferences in the European Parliament
- 10:30-10:50 Discussant R. Beetsma (University of Amsterdam)
- 10:50-11:30 General discussion

Session 4: EU Budget Reform

Chair: Alexander Italianer (EU Commission)

11:30-11:50 **Keynote Speaker:** D. Gros (CEPS) – How to Achieve a Better Budget for the European Union

11:50-12:10 Discussant G. Szapary (Central European University, Budapest)

12:10-12:50 General discussion

14:15-14:35 L. Begg (LSE) - Financing the European Union Budget

14:35-14:55 W. Molle (Erasmus University, Rotterdam) – Assessing the Structure of EU Expenditure

14:55-15:15 Discussant J. Pisani-Ferry (Bruegel)

Session 5: Panel – Reforming the Budget, Changing Europe

Chair: Vitor Gaspar (EU Commission)

15:15-16:30 M. Montoliu Muñoz (World Bank)

A. Sapir (Université Libre Bruxelles)

J. Pelkmans (Collège d'Europe)

Concluding remarks: V. Gaspar (EU Commission)

Bringing Together Academic Expertise on the EU Budget

The EU budget is a key instrument of EU policy makers to achieve the goals of the Union and to address current and future policy issues. In order to be effective the EU budget must move with the times. The various dimensions of the EU budget - the way it is drawn up, its composition and implementation - need to adjust in a manner that is consistent with the principal policy challenges.

The Debate on the EU Budget: Criticism Abounds

Over the past several years the debate on the EU budget has become increasingly critical. While there are defenders and opponents of the *status quo*, there is also an audibly growing opinion that the current EU budget may not be conducive to achieving the declared objectives of EU policies. One particularly prominent stage of this debate goes back to more than five years ago, when a group of independent high-level experts produced the Sapir Report, which reached a relatively blunt verdict - describing the EU budget as a 'relic of the past'.¹

The debate was rekindled in 2005 when the Council agreed the current multiannual financial framework. However, the steps leading to the agreement were not so very different from those in previous budget negotiations. The final accord was reached after long and tedious negotiations where national positions clearly trumped common issues. When the agreement was at last announced in December 2005, there was a pervasive sense among observers and participants that a compromise had been reached for the sake of respecting procedural deadlines rather than for any other reason.

As part of the decision to adopt the financial framework 2007-2013, the December 2005 European Council and the Parliament invited the Commission 'to undertake a full, wide ranging review covering all aspects of EU spending, including the CAP, and of resources, including the UK rebate, to report in 2008/09.' The invitation reflects the growing discontentment about how financial resources are spent at the EU level, as well as doubts about whether EU priorities are being served.

As a first step in making the budget review a practical reality, the European Commission launched a public consultation in autumn 2007. The aim of the consultation is to encourage all interested parties to contribute openly to the debate on EU finances. Embedded in this broad-based consultation process, the Bureau of European Policy Advisers (BEPA) of the European Commission invited leading academics and experts to examine the

¹ Sapir, A., Ph. Aghion, G. Bertola, M. Hellwig, J. Pisani-Ferry, D. Rosati, J. Vinals and H. Wallace (2004) *An Agenda for a Growing Europe. The Sapir Report*, Oxford University Press, Oxford.

EU budget from different angles and to provide their views on the scope and prospects for reform.

The results of their analyses were presented at a two-day conference on 3-4 April 2008 in Brussels. The programme comprised in total twelve keynote speeches and papers grouped around four different thematic areas: (i) growth, transparency and reform (ii) redistribution, regional policy and agricultural policy; (iii) the political economy of the EU public finances; (iv) EU budget reform. These areas do not delineate distinct fields of interest or research with sharp and clear borders. Rather, they reflect an attempt to structure a broad field in which a number of topics are treated separately, largely for the sake of convenience and in order to facilitate the discussion. The full list of keynote speeches and papers is available on the BEPA internet website at: http://ec.europa.eu/dgs/policy_advisers/public_finance_conference_en.htm.

The conference attracted some 150 participants including high-level officials of the Commission services, from the EU Member States, think tanks and international organisations. With a view to documenting the event, these proceedings summarise the main points of the presentations and discussions and draw a number of tentative conclusions.

Setting the Scene: the Vision of the Future Budget

Dalia **Grybauskaitė**, the Commissioner responsible for Financial Programming and the EU Budget, opened the conference. In her speech she set out a vision of the future budget that highlighted three key dimensions:

(i) A new quality of the budget in terms of both composition and implementation. First, the structure of revenues and expenditures should better reflect the main policy priorities of the EU and, secondly, resources need to be used more effectively towards achieving specific policy priorities.

(ii) Adequacy of resources. The size of the budget should be in line with, and provide a stable basis for, the policy objectives and ambitions of the EU.

(iii) Better budgetary procedures should be designed in such a way as to enhance transparency, accountability and simplicity.

On the basis of these three perspectives, Commissioner Grybauskaitė encouraged the participants at the conference to engage in a frank and open discussion, remaining faithful to academic rigour but keeping in mind the politics of the EU budget process.



*Commissioner
Dalia Grybauskaitė*

Examining the ‘Patient’: Views and Insights from Academia



Philippe Aghion

The morning session on 3 April on ‘**Growth, Transparency and Reform**’ was chaired by Antonio **Cabral** (Special Adviser in the Cabinet of the President of the European Commission). The session started with a keynote speech by Philippe **Aghion** (Harvard University) on ‘*Innovation and Budgetary Policy over the Cycle*’ discussed by Ramon **Marimon** (European University Institute). Aghion’s main proposition was that the typical pro-cyclical pattern of R&D expenditure - i.e. reduced during slowdowns and increased in upturns - may affect the long-term growth prospects of an economy. The policy proposal that Aghion drew from this proposition is to design government budgets, including the EU budget, in such a way as to stave off the negative consequences of this pro-cyclicality. Abstracting from the specific mechanism examined by Aghion, Marimon’s speech linked up with an important area of research and policy which comes under the heading of ‘quality and composition of public spending’. The basic and quite intuitive idea underpinning the respective debate is that some items of government expenditures, including those disbursed at the EU level, are more conducive to economic growth than others.

In his discussion Marimon mainly challenged the empirical evidence put forward by Aghion that countries with stronger counter-cyclical fiscal policy exhibit higher economic growth. In particular, Marimon argued that sound findings had to be based on structural economic models rather than on simple regression analyses which cannot be used to answer the question of which direction the arrows of causality are pointing in.



Richard Hemming

Following the keynote speaker, Richard **Hemming** and Mark **De Broeck** (IMF) presented a paper on ‘*Transparency of the European Union Budget*’. Drawing on extensive previous work on good governance, Hemming and De Broeck took a closer look at how well the EU budget complies with the Fiscal Transparency Code used by the International Monetary Fund. The code is organised around four pillars: clarity of roles and responsibilities; open budget process; public availability of information; and assurances of integrity. The overall assessment turned out positive. However, the authors point to a number of areas for improvement, notably the limited flexibility and policy content of the annual budget, and the need to move to a medium-term expenditure framework and to put more emphasis on performance, i.e. linking inputs to outcomes.

Steffen **Osterloh**, Philipp **Mohl** and Friedrich **Heinemann** (Centre for European Economic Research - ZEW) presented a paper on ‘*EU Budget Reform Options and the Common Pool Problem*’. The presentation was in two parts. In the first part the authors sketched out a political economy model which explains one distinct feature of the EU budget, namely the bias towards distributive spending and the under-provision of public goods. The second part examined a number of reforms including correction mechanisms (arrangements that compensate Member States with an

‘excessive’ net contribution) which were found to support the desired shift from distribution to public goods provision.

Both contributions were discussed by Lars **Heikensten** (EU Court of Auditors). Referring to the paper examining alternative options for reform of the EU budget, Heikensten underlined the scope for shifting the allocation of expenditure in the EU budget away from distribution towards the provision of public goods, and conceded that the proposed options would be conducive to promoting such a shift. However, he pointed to the difficulty often encountered in practice of drawing a clear line between redistribution and public goods. Turning to the transparency of the EU budget, Heikensten made it clear that, while he broadly shared the assessment of Hemming and De Broeck, he felt that the picture painted in their paper was slightly too positive, as budget practices are not always in line with the budget documents used for the assessment. In his view there was a distinct need to provide clearer budgetary goals and to entrust the evaluation of the implementation of the budget against such goals to an independent body.



Lars Heikensten

The general discussion at the end of the first session centred mainly on the keynote speech given by Aghion. Three main types of considerations were put forward. The first concerned the methodological framework underpinning the empirical evidence provided by Aghion to support his proposition that counter-cyclical fiscal policy would not only stabilise output in the short term, but also foster long-term growth. Several speakers concurred with the point made by Marimon that strong policy conclusions - such as striking a blow for more active discretionary fiscal policy-making - should be derived from structural models. Linked to that, there was also the feeling that calling for more fiscal discretion meant turning a blind eye to the failings of fiscal discretion in the past. It was also argued that rather than calling for more fiscal discretion, Aghion’s proposition provided arguments in favour of measures for improving financial markets so as to allow firms to raise enough funds across all stages of the cycle.

The afternoon session on 3 April, chaired by Stefan **Lehner** (Directorate-General Budget, European Commission), focused on ‘**Redistribution, Regional Policy and Agricultural Policy**’. The keynote speech was given by Clemens **Fuest** (University of Cologne) and discussed by Sebnem **Kalemli-Ozcan** (University of Houston, ECB and CEPR). Fuest’s contribution was based on a paper co-authored with Johannes **Becker** (University of Cologne) which looked at the topical issue of tax competition in the EU from a fresh and innovative angle. Fuest reasoned that the co-ordination of investment in infrastructure among members of a union such as the EU was welfare-improving, inter alia because more investment mitigates tax competition. This proposition conflicts with the received wisdom according to which measures to increase factor mobility should lead to stronger competition for mobile tax bases.



Clemens Fuest

The comments and remarks by Ms Kalemli-Ozcan were predominantly positive. She found that Fuest's presentation clearly and elegantly addressed an important mechanism which so far had been neglected in the tax competition literature. However, two challenges were highlighted: (i) the likely difficulty of empirically testing the proposition derived from the theoretical model and (ii) reconciling the proposition of the paper with the prevalent finding that tax competition was actually good (i.e. welfare-increasing).



Catherine Moreddu

The keynote speech of the second session was followed by a presentation by Catherine **Moreddu** (OECD) who scrutinised in more detail the EU policy area that still absorbs the largest share of the EU budget - namely the common agricultural policy (CAP). The presentation began with a review of the CAP, including its successive reforms. According to OECD analysis, CAP reforms have reduced economic distortions in the sector, but support to producers remains at a significant level and is distributed unequally. As part of the discussion of a number of principles that should underpin any future reform, two principles received particular attention: (i) effectively target policies in terms of goals, scope and duration, and (ii) give priority to the functioning of markets, i.e. address market failures first and deal with income issues afterwards.

Alan **Swinbank** (University of Reading), the discussant of Moreddu's contribution, was more critical of the *status quo* of the CAP. He admitted that it had changed for the better, but pointed out that under current arrangements the budget allocations for the CAP were set to remain unchanged in nominal terms until 2013. He also questioned the relevance and desirability of both market price and income support in the light of high and rising commodity prices. Looking ahead, Swinbank was also sceptical about the likelihood of gathering sufficient political support to carry it through, in spite of the clear scope for a radical reform from an economic standpoint.



Vasja Rant

The other two papers of the second session examined the thorny issue of national interests and redistribution across countries. The first of the two papers was delivered by Mojmir **Mrak** and Vasja **Rant** (University of Ljubljana) and was on the '*Financial Perspectives 2007-2013: Domination of National Interests*'. The paper proposed an empirical test of the widely held notion that national interests were the key determinants of the outcome of the multi-annual EU budgetary framework, whereby national interests are proxied by the composition of the net balances of member states in terms of major policy areas, the CAP, Cohesion policies and Other (Internal policies, External policies, Administration, Compensations). The test consisted in grouping countries on the basis of the proxied national interests and comparing these groupings with the coalitions actually formed in the negotiations on the financial framework. The outcome of the test was reported to corroborate the initial hypothesis.

The second paper dedicated to the issue of national interests and cross-country redistribution was by Angel **De la Fuente** (Spanish National Research Council), Rafael **Domenech** (Oficina Económica del Presidente and University of Valencia) and Vasja **Rant** (University Ljubljana). The paper puts forward a proposal aimed at overcoming the burden imposed on the EU budget negotiations by the Member States' main preoccupation with having to defend or improve their net financial contributions. At the core of the proposal is the idea that negotiations should be divided into two stages. The first stage would be purely redistributive, where Member States receive (pay) transfers in relation to their relative income levels. In the second stage, negotiations would be about the provision of public goods and other common issues.



Angel De la Fuente

Ludger **Schuknecht** (European Central Bank), who discussed both papers, broadly agreed with the concepts put forward by the authors, yet saw a number of practical problems and difficulties. As regards the paper by Mrak and Rant, Schuknecht's main point took up an issue that had been highlighted in the first session of the conference by Heikensten, namely that it was difficult to draw a clear and consistent dividing line between purely national and common spending. Concerns about the practical viability were also in the forefront of Schuknecht's discussion of the second paper by De la Fuente *et al.*. In particular, he found that the idea of decoupling the issues of redistribution and allocation in the EU budget negotiations, while it may possess clear merits, had to be underpinned by operational details to allow an overall assessment to be made.

The general discussion was in two parts, thus reflecting the structure of the second session. Given the sensitivity of the topic, the first part on the CAP was particularly lively and covered a very broad spectrum of alternative positions, ranging from an indirect defence of current arrangements to the radical proposal to abolish the CAP altogether. With reference to broader EU issues, the CAP was characterised among others as a sort of 'EU purse' to buy political consent for important steps in the European integration process. On a more pragmatic note related to the question of how to reform the CAP, speakers felt that there was a risk of becoming bogged down in technical details. Before engaging in a reform debate, one must first address the 'big issues' such as: Should money be spent to support agriculture? If so, who should spend it? The EU or Member States?



The second part of the general discussion revolved around the question of how to (re)design the negotiation of the EU budget so as to give more prominence to community as opposed to distributive spending. One

important point made in this context was that focusing exclusively on net financial positions (as was the case in the papers by Mrak and Rant and De la Fuente et al.) may be too narrow or even distortive for the purpose of the exercise. It was argued that a significant proportion of EU public goods that were paid for out of national budgets were not considered in the analysis made by the two papers on distribution and national interest. The observation was also made that any reform of the redistributive part of the EU budget had to take into account some of the key principles underlying EU expenditures; specifically, a potential conflict was detected between the proposal of pure redistribution advocated by Fuente *et al.* and the principle of additionality. Also, it was felt that the strict decoupling of redistribution and provision of EU public goods carried a risk of undermining the rationale for an EU budget as such.



Mark Pollack

The third session, chaired by Marco **Buti** (Deputy Director-General of DG ECFIN, European Commission), started the second day of the conference and marked a significant shift in perspective. In contrast to the first day, which had been largely dedicated to specific aspects of the formation and implementation of the EU budget, the third session focused on the '*Political Economy of the EU Public Finances*'. The keynote speech on '*Member State Principals, Supranational Agents and the EU Budgetary Process, 1970-2008*' was delivered by Mark **Pollack** (Temple University), who examined the distribution of power in the EU budgetary process. The main line of reasoning of his presentation was to argue that, while there was a formal, and growing, tendency to emphasise the role of the EU Parliament as one half of the EU's 'budgetary diarchy', the budgetary process has been and still is largely under intergovernmental control, especially as a result of the principle of unanimity in setting the EU's own resources and the multiannual financial framework. In Pollack's view, what the Lisbon Treaty essentially does is codify current practice with respect to the European Parliament's role in the annual budgetary process, while giving the financial framework greater 'path dependence', which can only be altered by a unanimous vote of the member governments.

In his discussion, Johannes **Lindner** (European Central Bank) qualified the rather critical assessment made by Pollack. Looking back in time, Lindner stressed that, with the introduction of the multi-annual financial framework in 1988, the budgetary process had become considerably less contentious. He also took a somewhat more balanced approach in assessing the implications of the Lisbon Treaty for the budgetary process, arguing that there were both challenges and opportunities here and that the eventual outcome would very much depend on the implementation of the new provisions.

Steffen **Osterloh**, Philipp **Mohl** and Friedrich **Heinemann** (Centre for European Economic Research - ZEW) presented a paper on ‘*Who Is Afraid of an EU Tax and Why?: Determinants of Tax Preferences in the European Parliament*’, which was discussed by Roel **Beetsma** (University of Amsterdam). The paper presents the results of a survey of Members of the European Parliament in 2007 with a view to identifying the factors that determine the support (or the lack of it) for an EU tax as a ‘true’ own resource of the EU budget. Most of the statistically significant findings were in line with expectations. In particular, the survey revealed a statistically significant impact of political ideology and a number of characteristics of the country of origin. Taking political affiliation as a starting point, Greens and socialists turned out to hold a particularly favourable view of an EU tax, whereas liberals and centrists were less keen. As regards the country of origin, the size of government was found to be an aspect that generates support. By contrast, Members of Parliament from recently acceded countries turned out to be rather critical, the most likely reason being that an EU tax is seen as a way to restrict national tax autonomy which has been used extensively in the years following accession to attract FDI.



Friedrich Heinemann

In his discussion, Beetsma paid tribute to the originality of the paper and the originality of the dataset underpinning the empirical work. In his view the paper helped in understanding what shapes the opinions of Members of the European Parliament, but was less informative about the likelihood of there being an EU tax in the near future, because the EU budget is decided by the EU Council.

The main theme of the general discussion was the institutional and political framework underlying the formation and implementation of the EU budget. One particularly problematic element in the current institutional set-up that was singled out in the debate was the current duality in EU legislation, where the responsibility was shared between the Council and the Parliament, while the establishment of the budget was *de facto* dominated by the Council. There was a general feeling that a number of issues needed to be clarified in order to effectively use or



steer the incentives of the players involved towards a reform of the EU budget. A number of participants raised the issue of the actual distribution of roles and the ultimate level of accountability. For instance, is the Council the ‘agent’, acting on a mandate from the citizens, or is the Council the ultimate ‘principal’ that delegates some tasks to the Commission? The general discussion also touched upon the question of a ‘true’ EU tax. The point was made that, in the absence of an own EU agency collecting taxes, any distinction between national taxes devolved to the EU budget or ‘true’ EU taxes would always be rather virtual and would have no practical implications.



Daniel Gros

The fourth and last session of the conference entitled ‘*EU Budget Reform*’ was chaired by Alexander **Italianer** (Deputy-Secretary General of the European Commission) and started with the keynote speech by Daniel **Gros** (Center for European Policy Studies – CEPS) on ‘*How to Achieve a Better Budget for the European Union*’. At odds with its somewhat programmatic title, the speech started with a very frank analysis of the *status quo*. Two critical and interrelated points were made: (i) the EU budget does not match the evolving ambitions of the EU; (ii) the decision-making mechanisms are not conducive to change and do not provide incentives to overcome the focus on national net balances. In the face of this rather harsh diagnosis, Gros advocated ‘sunset clause’- mechanisms whereby major spending programmes would expire at a predefined date unless their effectiveness and scope for extension are established.

György **Szapary** (Central European University, Budapest), the discussant of Gros’ contribution, began his speech by adopting the standpoint of the recently acceded Member States. He questioned to some extent the view that had been repeatedly aired at the conference, namely that the EU budget was excessively redistributive. He felt a certain continuity in the structure of the budget was necessary to ensure that ‘new’ Member States could receive the benefits that ‘old’ Member States had been enjoying for decades. Apart from this aspect of ‘fairness’, and drawing from examples where EU spending had been crowned with success, Szapary saw a clear potential for improving the efficiency of EU spending by integrating efforts into a single long-term strategy. In concrete terms, Szapary identified the Lisbon strategy as possibly the best ‘container’ for such a strategy, which he would bolster with enforcement mechanisms similar to those of EU fiscal surveillance, i.e. including sanctions. A reform of the unanimity principle was also seen as a necessary condition for an effective budget reform.



The presentations by Gros and Szapary were followed by a very lively and rich general discussion. Three issues received particular attention. The first group of comments and remarks related to Gros’ pessimistic analysis of the *status quo* and the prospects for change. While many participants agreed that the *status quo* exerted a considerable gravitational pull, there were a number of bright spots at the horizon. Firstly, it was argued that the net balance position on major spending areas of the budget, such as the CAP, would change by the

end of the current financial framework, meaning that national preferences and positions in the budget negotiations, too, would change. Similarly, with time, the difference between ‘old’ and ‘new’ Member States in terms of the net benefits of certain spending policies was set to narrow. Secondly, and again looking ahead, the point was made that there would be further changes to the Treaty, or new Treaties which would provide the opportunity for improvements in the arrangements governing the formation

and implementation of the budget. Moreover, attention was drawn to the so-called ‘passerelle’ provision of the Lisbon Treaty, according to which the Council would have the possibility to decide unanimously that in future the financial framework would be adopted by a qualified majority.

The second group of comments and remarks concerned the application of the sunset-clause proposal put forward by Daniel Gros. The idea was welcomed, although this welcome was qualified in a number of ways. First, it was noted that such clauses implicitly or explicitly already existed in the current budget (e.g. for structural funds the qualification criteria for regions already act as a kind of sunset clause). It was also suggested that sunset clauses be extended to cover institutional arrangements, such as collective decision-making mechanisms. A third suggestion was to complement sunset clauses with dynamic ‘health checks’ establishing compliance with the subsidiarity principle. The third group of interventions concerned the assessment of the major spending areas of the EU budget. The point was made that previous reforms of the CAP had already gone a long way towards refocusing spending on the provision of public goods (e.g. biodiversity, preservation of rural landscapes). On the issue of structural funds, some comments and remarks took issue with the idea that the main impact of the CAP reform was redistributive. To the extent that lagging countries had higher productivity levels, structural funds could be seen as a way to channel capital towards more efficient uses across countries. However, it was also underlined that the lack of capital mobility within countries was a clear indication that, in addition to channelling capital, there was a clear need to work on institutions. A general concluding comment was that the Council and the Commission had already set in motion a number of initiatives in line with the Gros and Szapary proposals; however, these had not achieved visibility, either because they were not visible enough or because they were not incentive-compatible such as to influence the behaviour of the Member States. Neither possibility was considered to be particularly comforting or to provide scope for further thinking inside the Commission.

The last two presentations of the fourth session took a closer look at how best to restructure the revenue and expenditure side of the EU budget. In both cases, it was pointed out that the results were provisional, as the respective projects were still ongoing. Ian Begg’s (London School of Economics) contribution on ‘*Financing the European Union Budget*’ took a two-step approach. The first step highlighted the main points of conflict in the current system of and debate on EU resources (net contributors versus net receivers, a broad-based hostility towards ‘genuine’ EU taxes, and conflicts between the main institutional players, i.e. Council, Commission and Parliament). In the second part of the presentation, Begg sketched out a number of options and assessed their feasibility. He argued



Ian Begg

that a system of ‘true’ own resources would be more difficult to achieve as compared to a system purely consisting of intergovernmental transfers. As regards the time frame, Begg felt that a reform of EU resources would extend over the medium term and be unavoidably combined with a reform of expenditures.



Willem Molle

A forthcoming reform of the expenditure side of the EU budget was discussed in the presentation by Willem **Molle** (Erasmus University Rotterdam) entitled ‘*Assessing the Structure of EU Expenditure*’. Molle made it clear from the outset that, at the current stage of his work, the main objective consisted in providing details about the planned method to be used for the assessment of the current spending structure. In particular, he presented an outline of an extended subsidiarity test designed to judge whether policies should

best be implemented at EU level or by Member States individually. Molle emphasised that such a test would examine only the ex-ante case for involving the EU (mainly on the basis of the findings of the literature on fiscal federalism) and would not deal with the efficiency or effectiveness of the implementation of spending programmes. The latter, although deemed to be important, was seen as a separate issue in its own right. Molle illustrated the key elements of the test procedure using spending on R&D and on higher education as examples. On the basis of these tests, R&D policies should be moved further up to the EU level, whereas current arrangements for higher education appear to be fine.

In his discussion of Begg’s and Molle’s presentations, Jean **Pisani-Ferry** (Bruegel) raised a series of questions about the prospective reform of the EU budget. He began with the issue of whether a ‘health check’ of the EU budget (including a test for subsidiarity) should be based on normative principles only or whether political economy considerations (the EU is more immune to pressure from national vested interests, the EU budget could provide incentives for national reforms) should also play a role. Turning to the question of flexibility versus stability of the EU budget, Pisani-Ferry argued for more flexibility as this would be instrumental to achieving current and future policy priorities. Pisani-Ferry also outlined alternative options for negotiating future budgets/multiannual frameworks. Instead of putting the CAP in the forefront and treating the remaining considerations as secondary, as had been the case in the past, he saw considerable scope for either putting the provision of public goods at the centre of the negotiations or getting the discussion of net balances out of the way first, so as to be able to concentrate thereafter on content.

Reforming the Budget, Changing Europe: a Panel of Prominent Views

The final part of the conference, chaired by Vitor **Gaspar** (Director-General, Bureau of European Policy Advisers) set the stage for three eclectic yet focal reflections on the EU budget and possible future reforms of it. The panel members were Marisela **Montoliu Muñoz** (World Bank), André **Sapir** (Université Libre Bruxelles) and Jacques **Pelkmans** (Collège d'Europe).

The specific angle taken by **Montoliu Muñoz** was to assess the EU approach to regional disparity and development – one of the most significant areas receiving EU budget funding – in the light of the experience accumulated at the World Bank.² Starting with the conceptual substructure, Montoliu Muñoz argued that a certain degree of spatial concentration of economic activity was inevitable and probably efficient, whereas persistent sizeable regional differences in living standards were not. To achieve spatial agglomeration of economic activity and spatial convergence in social welfare simultaneously requires *market integration*, which includes eliminating barriers to mobility of products and labour and shrinking the distance between leading and lagging regions. The key to success in achieving market integration, particularly when facing tight budget constraints, lies in minimizing economic distortions and possible adverse effects on overall national growth.



*Marisela Montoliu
Muñoz*

Turning to the European context, Montoliu Muñoz described the EU's regional integration strategy as the most prominent and successful global example to date, built on a complex and gradual process of institutional and policy harmonization efforts stretching back to its inception in the late 1950s. In her view, however, the EU's convergence and cohesion policies appeared to have had mixed results. For instance, there had been visible progress in economic and social convergence between EU member countries, but apparently this had had been less so across regions within countries.

Montoliu Muñoz noted the interesting debate in the earlier sessions of the conference, in which convergence/cohesion policies had been described alternatively as little more than a means to address issues of 'national net balances' in the EU budget, and as a question of the 'moral obligation' of richer countries in the Union towards the poorer ones. She suggested that a more promising and sustainable approach would be to recognize the value

² The Bank is currently collecting this experience in the context of the preparation of the World Development Report 2009 on *Reshaping Economic Geography*, to be issued in October 2008.

of convergence as an ‘economic good’ for countries in the Union (and possibly to some extent, a ‘public’ good for the Union, if linkages between social welfare, political stability, environment, and security spillovers were taken into account). This would further improve the chances of regional policy being subject to a strict discipline of ex-ante cost-benefit evaluation, careful implementation, and ex-post outcome monitoring. However, she concluded that it was important that the full burden of funding social welfare convergence in the union did not have to fall on the EU budget alone; it should be placed instead within the broader financing architecture, which also included bilateral and multilateral funding, foundations, and the private sector.



André Sapir

Sapir’s reflections had a particularly important connotation, as five years previously he had played a leading role in drafting the report which reviewed EU policies and the budget. He prefaced his comments by putting the EU budget into perspective, pointing out that it was relatively small in terms of EU GDP and that it was by no means the only, and probably not the most important, instrument of EU policy making. The straightforward conclusion from this is that the EU budget can only address a limited number of issues and it should do so in conjunction with national public finances by acting as a facilitator or a lever on specific policies.

As to its content, Sapir concurred with the view expressed by more than one speaker at the conference that the EU budget should address common problems and common challenges (in particular, problems linked to the diversity of the 27-nation union, globalisation, climate change and neighbourhood) and that these challenges should be addressed by the provision of public goods rather than by transferring income across countries. He also very much agreed that it would be extremely difficult, if not impossible, to draw a clear line between the two. In order to get around this uncertain state of affairs, Sapir suggested a two-pronged approach to EU spending that combines distribution on the one hand with the provision of public goods on the other. The first part of the approach would be to hand out ‘distributive cheques’ to countries which would be linked to specific policy programmes and objectives. The second stage would consist in a detailed and independent assessment of the impact of the policies, in order to be able to decide what works and what does not.

With regard to the actual momentum and prospects for reform, Sapir partly shared Gros’ view about the dominance of the *status quo* bias. One of the likely - though discouraging - compromises that Sapir anticipated for the next round of negotiations was a situation in which the net recipients defend the current structure of EU spending, while net contributors insist on reducing the size of the budget. The outcome would be a smaller budget with unchanged spending patterns.

Following up on a proposal put forward by Heikensten in the first session of the conference, Sapir pointed out that a practical and potentially viable

improvement in the current institutional set-up geared towards making progress in the formation and implementation of the EU budget would be an independent evaluation office. In particular, Sapir saw a clear deficit in terms of both ex-ante and ex-post evaluation of EU policies. In his view this deficit was contributing to the *status quo* bias, as there was not sufficient publicly available information about the actual impact, or lack of it, of EU spending. Put another way, Sapir stressed that more and better evaluation would lead to the need for change being articulated and, in turn, create more demand for change.

Pelkmans began his presentation announcing that he was going to be deliberately provocative. His main proposition was that the EU budget should in fact be of peripheral importance for EU policy makers - and that the EU was not about money but about rules. In concrete terms, Pelkmans was arguing that, taking EU policymaking as a whole, the importance and impact of regulatory initiatives on the economies and the societies of the Member States are significantly greater than the effect of disbursing money which amounts to around 1% of the EU's GDP. Against this backdrop, when assessing EU expenditures, Pelkmans strongly stressed that, on top of the traditional subsidiarity test of EU versus national implementation, we should also be engaging in an appraisal of the relative effectiveness of budgetary versus non-budgetary instruments. He maintained that, in many policy areas where the EU is currently active, regulations would have a bigger impact than spending money.

To illustrate his point, Pelkmans used the example of R&D and cohesion policy. To start with, he pointed to the significant gap between the US and the EU in terms of private R&D spending as a percentage of GDP which, in his view, could not simply be bridged by raising public sector spending. The more promising channel would be legislative instruments that create appropriate incentives for private firms. As regards cohesion policies, Pelkmans forcefully made the point that effective implementation of the internal market programme, trade and competition policies, together with macroeconomic stability, was far more important for economic convergence than money spent through the Cohesion or Structural funds. He used the case of Greece and Italy to underline his point, arguing that those countries had benefited more from policies geared towards improving the regulatory framework than from money spent under the heading of regional policies. Overall, Pelkmans conceded that there was scope for reforming the current budget and that such reforms would be carried out gradually. However, he felt that, because of the relatively minor role of the budget compared to other EU policy-making tools, the pessimism conveyed in Gros' presentation was unwarranted.



Jacques Pelkmans

Wrapping up the conference, **Gaspar** thanked all speakers, discussants and participants for their contributions. He emphasized that the conference had covered a wide range of difficult and complex issues in an impartial and thorough manner, collecting and comparing a wide range of opinions. In

this connection, he also pointed out that despite the potentially conflicting viewpoints in the public domain on the EU budget, the exchange of views had been both frank and constructive. Gaspar concluded that as a result of this frank and constructive climate the conference had helped to better identify the main issues related to the prospective reform of the EU budget and that the insights gained during the conference would provide useful input for the ongoing review exercise.

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