



Thinking the EU budget and public spending in Europe: the need to use an aggregate approach



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Contemporary EU debates on public finances are particularly animated. Discussions have been going on about the post 2013 financial framework, with a particular focus on how to finance “smart, sustainable and inclusive growth” in the coming years but also on how to ensure the “added value” of the EU budget¹. This debate takes place in a context of fiscal consolidation at the national level. Most member states face severe difficulties in the management of their public finances due to the combination of several factors: the effects of the financial crisis, the level of public debt and the need for active stabilizing policy intervention to support growth and employment.

In this constrained environment, the question of “how to spend public money in a better way” is raised in an acute way. At the EU level, the current debate on the future of the EU budget reveals that the focus is nowadays on “how to spend better together” rather than “how to spend much more together”. In this respect, there is a growing interest on the possibility of achieving efficiency gains by reinforcing the coordination of national and EU spending and by adopting an aggregate vision of total public spending in the EU. In other words, to strengthen the multi-level governance of public finances in the EU appears as a means to increase the efficiency of public expenditure.

The purpose of this paper is to show the benefits of adopting an aggregate approach to analyse public finances in the EU. Adopting an aggregate approach means having a general picture of public finance at the EU level, as well as at the national level. As underlined by Barbier-Gauchard and Bertoincini (2009)², this aggregate approach of public spending in the EU is necessary to contribute to discussions on the post 2013 financial framework:

- Firstly, it enables us to assess the total level of public spending in the EU and to obtain a better vision of the EU’s main financial priorities.
- Secondly, most of the spending carried out by the EU takes place in fields of competence “shared” with Member States, and is thus frequently accompanied by very significant national spending. The same is true for spending which derives from intergovernmental cooperation organised under the supervision of the EU institutions (such as in the area of foreign policy), which is to a large extent subordinate to national spending.
- Thirdly, an aggregate presentation of European public spending also enables us to state that the Community budget is already strategic in some sectors and for some countries. It is useful to help identify the sectors which merit more political consideration.
- Fourthly, the willingness to align Community spending to the priorities of the “Europe 2020” Strategy must not obscure the fact that implementing this strategy is chiefly incumbent on Member States themselves, whose actions are coordinated through the so-called “Open Method of Coordination”: it thus also seems logical to incorporate the spending they carry out into the analysis, something done only very occasionally (such as for R&D spending).
- Fifthly, it also enables us to answer a longer-term question: is the current distribution of public spending between the EU and the national level comparable, or required to be comparable, with the distribution observed in other confederal or federal entities (such as the United States, Canada or Switzerland)? The purpose of such international comparisons is first and foremost to provide factual assessment items that can be every bit as illuminating as traditional information of the theory of ‘fiscal federalism’. These comparisons also recall the need to take account of the specific nature of the European politi-

1. See in particular the Communication of the European Commission (2010) entitled “The EU Budget Review – Communication from the Commission to the European Parliament, The Council, the European Economic and Social Committee, the Committee of Regions and the national parliaments”, COM (2010)700 final, 19.10.2010.

2. See BARBIER-GAUCHARD Amélie and BERTONCINI Yves (2009), *Scoreboard of public spending in the European Union and its Member States*, Centre d'Analyse Stratégique, September.

cal context, and the fact that any consideration of the distribution of public spending between the national and the Community level cannot be restricted to its purely technical aspects (whether there are any externalities, public goods, etc.).

After presenting the current distribution of spending tasks in the EU (section 1), we draw attention to

EU policy priorities by policy area (section 2). We then present the EU structure of multi-governance of public finance as an atypical kind of fiscal federation compared to the United States, Canada or Switzerland (section 3). We conclude by pointing out the economic rationales in favour of more fiscal intervention at the EU level to benefit from the “added value” of public spending at the EU level.

1. A better vision of the current distribution of spending tasks in the EU

The EU is *de facto* a fiscal federation. A fiscal federation is a particular kind of public finance governance which involves a sharing of fiscal power between different levels of public actors. In the particular case of the EU, public actors are represented by the Community level, the government of each EU Member State, and regional and local authorities. In a fiscal federation, each level of fiscal power is relatively independent but still financially connected to the others.

As shown in table 1, the current task assignment of public spending between the EU and the national level presents some particular features. In this Table, national and Community public expenditure are presented in a framework consistent with the European Financial Perspectives 2007-2013. This table enables us to distinguish three types of public spending:

- Public spending mainly financed at the EU level (such as direct aid to farmers);
- “Shared public spending”, financed jointly by the EU and the national level (such as spending in the areas of cohesion, rural development, humanitarian aid, external public aid or R&D and competitiveness);
- Public spending mainly financed at the national level (such as spending in education, health, social welfare or defence).

It is essential to have these elements of the distribution of tasks in mind when looking at the EU financial negotiations and to keep in mind that focusing on a “narrow” EU approach (i.e. not aggregate) gives a false vision of the real financial spending undertaken by the EU public authorities (at all levels, but especially at the national level).

TABLE 1 - MULTI-LEVEL GOVERNANCE OF PUBLIC FINANCES IN THE EU (2008)

	EM	UE
1A. COMPETITIVENESS FOR GROWTH AND EMPLOYMENT	99,7%	0,3%
TECHNOLOGICAL RESEARCH AND DEVELOPMENT	93,6%	6,4 %
ENERGY AND TRANSPORT	99,1%	0,9%
EDUCATION AND TRAINING	99,9%	0,1%
INNOVATION AND COMPETITIVENESS	97,3%	2,7%
MANAGEMENT OF SOCIAL CHANGES (INCLUDING SOCIAL WELFARE)	100,0%	0,0%
1B. COHESION FOR GROWTH AND EMPLOYMENT	83,6%	16,4%
STRUCTURAL AND COHESION POLICIES	50,0%	50,0%
HOUSING	100,0%	0,0%
2. CONSERVATION AND MANAGEMENT OF NATURAL RESSOURCES	65,5%	34,5%
AGRICULTURE	28,0%	72,0%
RURAL DEVELOPMENT	33,0%	67,0%
FISHING	28,2%	71,8%
ENVIRONMENT	99,8%	0,2%
3. CITIZENSHIP, FREEDOM, SECURITY AND JUSTICE, HEALTH	99,9%	0,1%
FREEDOM, SECURITY AND JUSTICE	99,8%	0,2%
CITIZENSHIP	99,5%	0,5%
HEALTH	99,9%	0,1%
4. THE EU AS A GLOBAL PARTNER	96,9%	3,1%
EXTERNAL AID, INCLUDING DEVELOPMENT AID	88,4%	11,6%
HUMANITARIAN AID	63,3%	36,7%
COMMON FOREIGN AND SECURITY POLICY (CFSP)	100,0%	0,0%

SOURCE: BARBIER-GAUCHARD (2008)

2. What is the real hierarchy of public spending by policy area?

As shown in table 2 and figure 1, the hierarchy of total public spending by policy area (national spending + Community spending) reflects the strong priority given by European countries to social welfare (and health) spending as well as to other spending items devoted to “competitiveness and growth”.

European public spending is chiefly allocated to spending on:

- growth and competitiveness (57% of spending);
- freedom, security, justice, etc. (20% of spending).

It is devoted to a much more limited extent to spending on:

- external relations, including defence (4% of spending);
- territorial cohesion (3% of spending);
- conservation of natural resources, including agriculture (3% of spending).

More precisely, as shown in table 2, over half of European public spending is devoted to management of social change (41.4%, of which 39.7% was spent on social welfare and 1.6% on active policies for the labour market) and health (14%). On the contrary, agricultural spending, structural spending and spending on cohesion each represents only 1.1% of total public spending, that is ten times less than spending in education and training.

TABLE 2 - HIERARCHY OF EUROPEAN PUBLIC SPENDING BY POLICY AREA AS A % OF TOTAL (2008)

MANAGEMENT OF SOCIAL CHANGES*	41.4%
HEALTH	14.2%
EDUCATION AND TRAINING	11.3%
ADMINISTRATION	6.5%
DEBT SERVICING	5.8%
FREEDOM, SECURITY AND JUSTICE	3.8%
FOREIGN AND DEFENCE POLICY	3.4%
CITIZENSHIP AND CULTURE	2.3%
ENERGY AND TRANSPORT	2.2%
RESEARCH AND DEVELOPMENT	1.5%
AGRICULTURE	1.1%
COHESION	1.1%

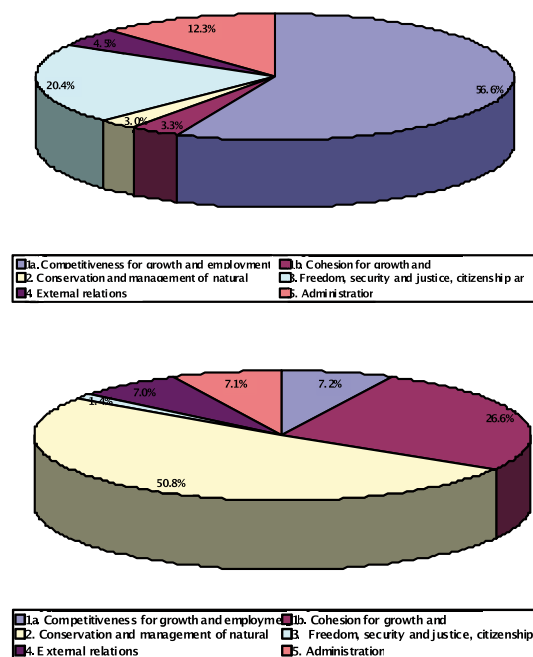
* Management of social changes = social welfare + active labour market policies

SOURCES: EUROSTAT, OECD

Given their relative weight, the breakdown per sectors of Community spending is very atypical if different from the breakdown per sectors of European integrated spending (see figure 1):

- on the one hand, because this spending does not cover social welfare and health (neither does it cover debt);
- and on the other hand, because the majority of this spending is carried out in the fields of conservation and management of natural resources (including agriculture and the environment) – 51% – and territorial cohesion – 27%.

FIGURE 1 – EUROPEAN AND COMMUNITY PUBLIC SPENDING PER POLICY AREA (2008)

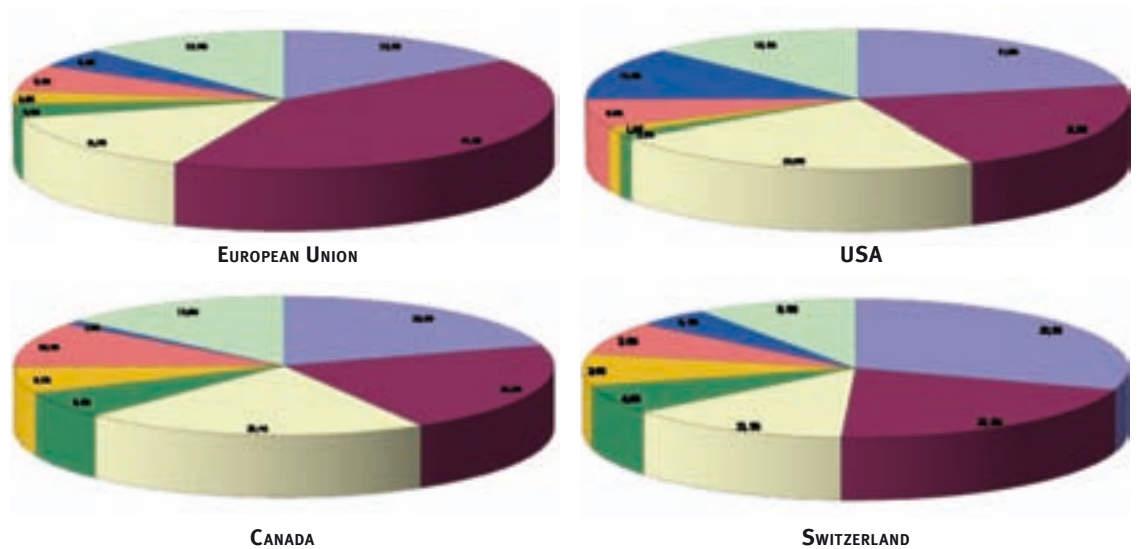


COMMUNITY PUBLIC SPENDING
SOURCES: EUROSTAT, OECD

As shown in figure 2, the hierarchy of total public spending in the EU as a whole is nevertheless identical to the hierarchy seen in the United States, Canada and Switzerland for the first three spending headings (“competitiveness”, “management of social changes” and “health”). It is different for the other two sectors:

- spending on natural resources (including agriculture) is in 6th place in Europe, 5th place in the USA and 4th place in Canada and Switzerland;
- spending on external relations is in 4th place in Europe and the USA but in 6th place in Canada and Switzerland.

**FIGURE 2 - PUBLIC SPENDING PER POLICY AREA AS % OF TOTAL (2008):
COMPARISON BETWEEN THE EU, THE US, CANADA AND SWITZERLAND**



■ Competitiveness for growth and employment	■ Management of social changes*
□ Health	■ Cohesion for growth and employment
■ Conservation and management of natural resources	■ Freedom, security and justice, citizenship and culture
■ External relations	□ Administration

*Management of social changes = social welfare + active policies for the labour market

SOURCES: EUROSTAT, OECD

3. The EU, an atypical case of “fiscal federation” ?

As underlined by Barbier-Gauchard (2008), the current structure of multi-level governance of public finance in the EU seems very different in some respects to that of the United States, Canada or Switzerland.

First, total European public spending (national spending + Community spending) proves to be higher than the spending recorded in the United States, Canada or Switzerland as shown in Table 3. However, the small size of the central budget is a specificity of the EU. Whereas the federal budget represents between 10 and 25% of the national GDP, the Community budget corresponds to around 1% of the EU GDP. EU budget is then very small (less than 1% of EU GDP) compared to national budgets (around 45% of EU GDP on average). Member States are responsible for almost 98% of total public expenditure in the EU.

Box 1 – UNITED STATES, CANADA AND SWITZERLAND AS “BENCHMARKS” FOR COMPARISON

THE UNITED STATES, CANADA AND SWITZERLAND ARE CHOSEN AS BENCHMARKS FOR AT LEAST THREE MAIN REASONS. FIRST, THESE FISCAL FEDERATIONS PRESENT A LEVEL OF ECONOMIC DEVELOPMENT SIMILAR TO THE EU, ALLOWING COMPARISONS OF THE STATE OF THE MULTI-LEVEL GOVERNANCE OF THE PUBLIC FINANCE. SECOND, LIKE THE EU, THESE FISCAL FEDERATIONS STARTED BY CREATING A MONETARY UNION BEFORE IMPLEMENTING FISCAL INTEGRATION. THIRD, THESE FISCAL FEDERATIONS CONSTITUTE THREE DIFFERENT KINDS OF MULTI-LEVEL STRUCTURES OF GOVERNANCE OF PUBLIC FINANCE, RANGING FROM A VERY CENTRALIZED STRUCTURE (LIKE THE UNITED STATES) TO A VERY DECENTRALIZED STRUCTURE WITH A LARGE AUTONOMY FOR SUB-CENTRAL LEVELS OF FISCAL POWER (LIKE CANADA OR SWITZERLAND). IN THIS PERSPECTIVE, FISCAL FEDERALISM APPEARS AS A FLEXIBLE MANNER TO ORGANIZE PUBLIC FINANCE WHEN SEVERAL LEVELS OF FISCAL POWER COEXIST. HOWEVER, SOME COMMON FEATURES EXIST BETWEEN THESE THREE FISCAL FEDERATIONS, SUCH AS THE LARGE SIZE OF THE CENTRAL BUDGET, THE IMPORTANCE OF VERTICAL FINANCIAL TRANSFERS BETWEEN THE CENTRAL LEVEL AND THE SUB-CENTRAL LEVELS OF FISCAL POWER, AND EVEN THE STRICT FISCAL DISCIPLINE IMPOSED ON SUB-CENTRAL LEVELS OF FISCAL POWER.

TABLE 3 - PUBLIC SPENDING AT TOTAL AND CENTRAL LEVEL AS A % OF GDP (2008)

	EU	UNITED STATES	CANADA	SWITZERLAND
TOTAL PUBLIC SPENDING	46%	33%	37%	34%
CENTRAL PUBLIC SPENDING	1%	25%	22%	11%

SOURCES: EUROSTAT, OECD

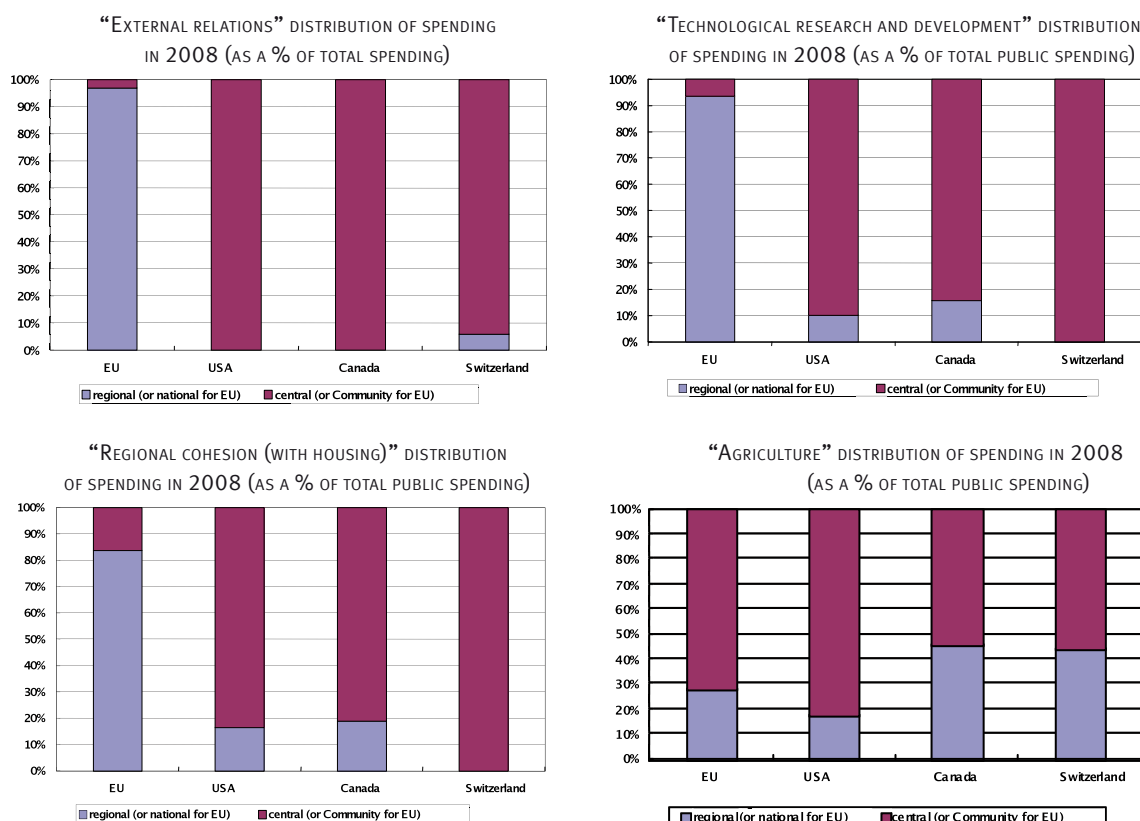
Second, the nature of EU public spending is also particular. In the US, Canada or Switzerland, vertical financial transfers between the central level and the sub-central levels of fiscal power are generally large : between 20 or 30 % of sub-central levels of fiscal power resources. These financial transfers aim at ensuring income redistribution between sub-central levels of fiscal power as well as stabilizing activity when an economic crisis occurs. In this context, the size of fiscal automatic stabilizers at central level can be important: around 20 % of the effects of an economic shock can be absorbed by federal grants. On the contrary, in the EU, Community transfers are mainly of structural nature. The relative weight of ‘distributed’ Community spending varies widely from country to country, first of all because this spend-

ing is spread differently (more agricultural spending in agricultural countries, etc.), but also and especially because of the heterogeneity among EU countries. These financial transfers represent only between 0,5 and 10 % of national public resources with deep heterogeneities between member states.

Moreover, in the EU the share of fiscal tasks between the different levels of fiscal power is very original in some policy areas.

Whereas spending on foreign policy, R&D, cohesion or agriculture is mainly centralized in most fiscal federations, this is generally not the case in the EU. Only public spending on agriculture is also centralized as well in the EU (see Figure 3).

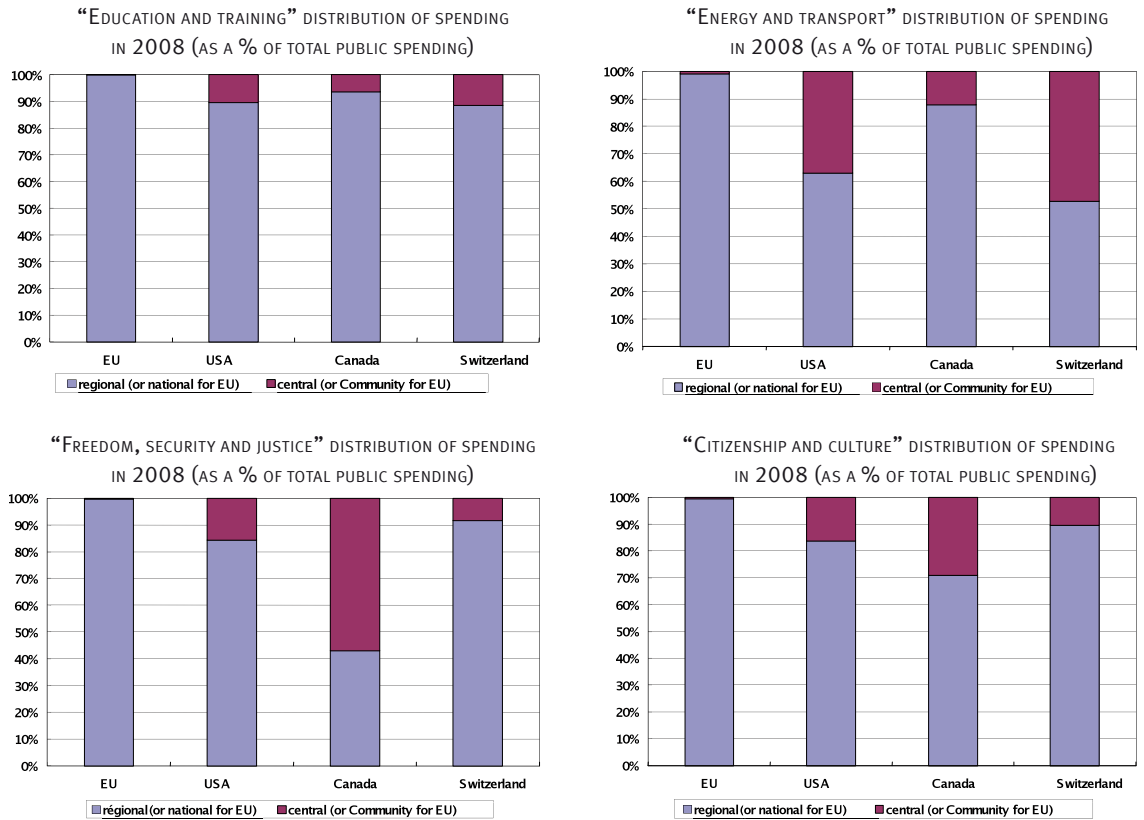
FIGURE 3 - POLICY AREAS IN WHICH PUBLIC SPENDING IS USUALLY CENTRALIZED: COMPARISON BETWEEN THE EU, THE US, CANADA AND SWITZERLAND



SOURCE: EUROSTAT, OECD

In contrast, in other policy areas, the distribution of spending tasks is not so different from what can be found in other fiscal federations, especially for “education and training”, “energy and transport”, “freedom, security and justice” or even “citizenship and culture” (see Figure 4).

**FIGURE 4 – POLICY AREAS IN WHICH PUBLIC SPENDING IS USUALLY DECENTRALIZED:
COMPARISON BETWEEN THE EU, THE US, CANADA AND SWITZERLAND**



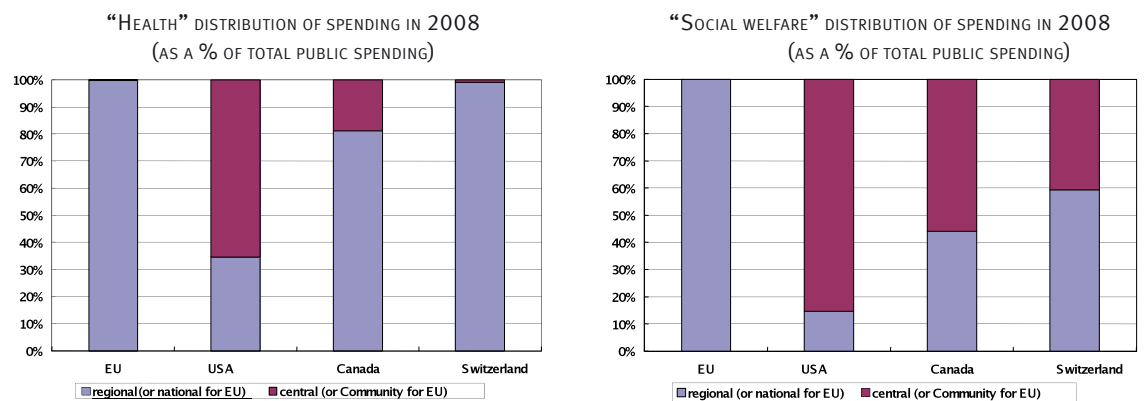
SOURCE: EUROSTAT, OECD

Finally, for other policy areas, the distribution of spending tasks does not follow a common pattern

among the different examples of fiscal federation (see Figure 5).

FIGURE 5 – POLICY AREAS IN WHICH THE DISTRIBUTION OF SPENDING

**TASKS DOES NOT FOLLOW A REGULAR PATTERN:
COMPARISON BETWEEN THE EU, THE US, CANADA AND SWITZERLAND**



SOURCE: EUROSTAT, OECD

CONCLUSION – The aggregate approach as a necessary tool to assess the “added value” of EU-level public spending

As noted by Rubio (2011)³, there are several ways of thinking “added value” of EU public spending, from an economic to a political point of view, each approach being not mutually exclusive. From an economic point of view, the “added value” of EU public spending is defined as the capacity of EU-level public spending to reach policy objectives in a more efficient way than national-level spending. In this context, “efficiency” refers to the ability to obtain similar results at a lower cost or the ability to obtain better results at the same cost.

To undertake an assessment of the added value of EU-level public spending we have to analyse whether some economic rationales could justify this “comparative advantage” of public spending at EU level compared to public spending at national level. In this perspective, we can follow the economic rationales proposed in particular by the fiscal federalism theory, which are at the basis of the subsidiarity principle.

A preliminary condition to be satisfied concerns the degree of heterogeneity in national preferences for public goods and services. This could be assessed by looking at the weight allocated to each public policy area in relation to total national public expenditure. The larger the degree of heterogeneity is, the more difficult is to formulate a common EU policy. For example, as heterogeneities for social welfare or health are large among European Member States, implying that more public spending in these areas at EU level is not realistic from a political point of view. On the contrary, some policy objectives could be designed at EU level when national preferences are similar (eg : environment).

We could then consider economic rationales to justify public intervention at EU level:

- When spillover effects/externalities exist at the Union level: it means that national economic activity may have effects on the other countries. When these effects are not taken into consideration by the country, EU intervention could be justified (eg: environmental policy).
- When economies of scale can be achieved to produce public goods and services at the EU level. It means that some costs of public policy can

be reduced by enlarging the scale of production (for example for fixed and uncompressed costs). In these cases, EU intervention is justified (eg: RTE).

- When leverage effects can be more important when policy is led at the EU level. “Leverage effect” means the ability of public spending to induce private investment. When a public policy can be more efficient in levelling private spending when carried out at the EU level, EU intervention is justified (eg : regional policy, competitiveness policy).

If one or several of these criteria are met, then public spending at the EU level could be more efficient, which means reaching EU policy objectives at a lower cost from a public finance point of view.

Adopting an aggregate approach is essential to assess the “added value” of EU level public spending. First, to assess whether public spending at the EU level provides ‘added value’, we need to know about the efficiency of public spending at the national level: actually, the question is not whether EU level public spending is efficient in absolute terms, but whether it is more efficient than national spending. Second, in many spending areas, the EU has a “shared competence”: in these areas, analyzing the efficiency of EU-level public spending requires also analyzing the level and type of vertical ‘coordination’ between EU and national spending.

To sum up, the question to answer should be : assuming that the overall level of public spending in the EU remains constant, could we have better results (i.e. could we be more efficient) by increasing spending at the EU level? When asking this question, it is important to take into account that, as a consequence of thinking at the EU level, policy objectives might adopt a European perspective. For example, for cohesion policy, thinking at the EU level implies considering regional inequalities at EU level, and not only at national level. Thus, there is no change in the policy objectives but policy objectives are considered on a larger scale: at the EU level ■

3. See, Rubio (2011), “The “added value” in EU budgetary debates : one concept, four meanings”, *Notre Europe*, Policy Brief N°28, June 2011.

Presentation of the project: “How to spend better together”

The negotiations about the EU budget after 2013 can't ignore austerity concerns but, due to its limited size, we cannot expect major savings from applying austerity at the EU-level.

A more intelligent response to the austerity challenge is to look at ways to make savings by better coordinating EU and national-level spending or by re-organising spending tasks. To explore these potentialities for efficiency gains, Notre Europe launches a set of publications under the title “How to spend better together”, which contains both transversal and sectoral analysis.

Each sectoral publication focuses on a specific policy area and is written by an expert on this policy area, which provides a different look to the question of “how to increase the added value of EU spending”. Some of them reject generally accepted ideas that circulate among EU budget debates. Others show us new ways to maximize the efficiency of public spending, which do not necessarily pass through changes in the EU budget. And, in general terms, they provide insightful analysis of the rationale and design of existing EU spending programs.

We hope that these publications will stimulate the debate on how to re-organize European public spending in different policy areas, and will provide a useful contribution to the discussions on the post 2013 EU financial perspectives.

To know more about this project: <http://www.notre-europe.eu/en/axes/competition-cooperation-solidarity/works/publication/how-to-spend-better-together/>

Presentation of the project: “A test for European solidarity”

With the economic and financial crisis having hit European countries in different ways since 2008, the EU is considering how far each country is responsible and what kind of solidarity is needed to overcome this challenge. Europeans have hastily set up solidarity mechanisms that their monetary union was lacking. Questions about the legitimacy and the limits of European solidarity are now very much being asked out in the open.

They are all the more crucial as they generate tensions in national public opinions and among European political decision-makers. These tensions are not just about macroeconomic issues but have recently been about solidarity mechanisms put in place in the ‘Schengen area’ and also relate to the different extents of other EU interventions, such as in the area of agriculture or energy.

In this context, Notre Europe's work is inspired by the vision of Jacques Delors, who advocates articulating European policies around three key points that are more necessary than ever: «Competition that provides a stimulus, cooperation that strengthens and solidarity that unites.» This vision, which embodied the Single Act of 1988, draws inspiration in particular from the 1987 report entitled « Stabilité, Efficacité, Équité » [Stability, Efficiency, Fairness], in which Tommaso Padoa Schioppa sets out how to push ahead with European economic and social integration in a balanced way.

Having put solidarity at the heart of the European forum of think tanks held in Barcelona in September 2010, Notre Europe has defined a broader project on this theme, which will allow it both to publish crosscutting reflection documents as well as ‘policy papers’ covering different sectors.

To know more about this project: <http://www.notre-europe.eu/en/axes/competition-cooperation-solidarity/projects/projet/translate-to-english-la-solidarite-europeenne-a-lepreuve/>