Reaction to the policy paper *A New Budget for the European Union?* by A. Iozzo, S. Micossi and MT. Salvemini

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A European Union Budget for the future

The paper by Iozzo and Micossi and Salvemini is very interesting, and for such a limited amount of pages, one of the clearest papers I have read. It puts together the best ideas of a number of existing works (Sapir, 2003, Heinemann et al. 2008; De La Fuente, 2008), and then makes them more relevant and better targeted to the realities of the EU budget. It is based, nevertheless, on a very questionable redistributive and allocative "European public goods" budget items separation. This separation looks well argued, but partially collapses if one looks more closely at the actual use of the funds, in particular those of the Cohesion Policy.

The use of more "real own resources" (taxes) to finance the European Public Goods is welcome, but the really important recommendation is the call for the creation of bonds for Common Project Financing. The use of financial instruments can greatly enhance the flexibility, effectiveness and the financial side of the budget without a large change in the actual funding of the budget.

The decision-making procedures on the EU budget are also a key element, and central to ensuring that the budget focuses better on the EU political objectives. This is central if one is to succeed in changing the dynamics of decision-making and improving the policy quality rather than just the net-balance status.

However, the financing mechanism proposed for the "redistributive" policies of the EU is detrimental and not an improvement from the present system. This response argues that it is unwise, even erroneous, to separate the budget in a "public goods" or "redistributive" group as presented.

Why the Redistributive and European Public Goods groupings are questionable

The separation between European public goods and redistributive policies is much more complex than is proposed within the paper, (see Begg's and Pietra's reaction). Notre Europe even claims that the direct payments of the CAP should not be considered "redistributive", even if only to put pressure to reform them. CAP payments are, however, the most, if not the only, clear redistributive part of the budget compared to all others, and putting them as a European public good would make the whole categorisation meaningless. Furthermore, based on the Iozzo et al. own interpretation of public goods, the market related measures should also not fall into the public goods section unless further reformed (see the Osterloh's reaction).

The major weakness of the proposal is that it ignores the Public Goods Nature of some of the policies they place as redistributive, and mysteriously ignore the existence of budgetary headings with ambiguous European public good characteristics. The separation, it is argued here, is rather controversial or even meaningless for most headings.

Some existing important budgetary headings are notably disappearing in there proposed rearranged budget structure. These are the rural development policy and the Trans European Networks, unless the later is considered part of the group of capital operations in the third group. Both aim to offer European Public Goods, in the case of rural development, at least the parts on the environment. But the biggest concern here is on the Cohesion Policy (Cohesion Funds, ERDF, ESF). The Cohesion Policy is not void of a European public good nature, and we should not forget that many of the public good policies, which the EU budget finances in wealthier member states for education, employment or research, are financed in the poorer member states through the Cohesion Policy. Lisbon oriented policies and the Trans-European Networks programmes go through the Cohesion

Policy (Cohesion Funds financing TEN transport and energy priorities and major environmental infrastructure priorities, and the structural funds financing a number of Lisbon oriented programmes and environmental interventions). As a matter of fact, the Cohesion Policy does not consist of a payment to individuals or workers in a sector, as is the case of the CAP. It is for poorer regions, but operations are aimed at fostering EU objectives and are not income support transfers, such as European transport networks, clean energy and innovation.

As an answer they offer the following simplifying solution "*we could agree that efficient redistribution should take the form of straight transfers, but they should still go through the common budget to highlight their function in promoting political acceptance of common policies*." (Miccosi et al. clarification in p.5 c). Straight transfers are a very big step backwards, dislodging the Cohesion Policy from European objectives. It eliminates one of the most important roles of these funds, promoting growth in line with European objectives through improving the strategic planning for development of regions and countries. This I consider to be (see Núñez Ferrer, 2007), one of the most important and most underrated roles of the Cohesion Policy. In fact, it would constitute a reversal to the original mechanism of transfers amongst member states in 1975, when the ERDF was introduced. It is the poor use of the funds and the low additionality in the results that prompted the European Commission to introduce the rules which still guide the implementation of the funds today.

In the paper, Iozzo et al. (ibid.) have also deleted the TENs from the budget (and do not explicitly mention them in the third group). This has somehow allowed a neater presentation of the two "allocative" and "distributive" groups, but are the TENs not European public goods, and are those not financed by the Cohesion Fund in poorer member states of the EU? A question arises why the same operations should be considered redistributive in the poorer regions.

How do we treat redistributive funding which has European public good characteristics? How can we argue that the same policies of the ESF (which are presented as Lisbon measures in the public goods group) or capital operations for richer regions are redistributive in the poorer regions and countries? Thus, de-facto, the main difference between many allocative or redistributive measures is their co-financing rate!

Also the rural development policy, while in need of improvement, has a number of public good elements and is used across all regions and countries. The text presents rural development as a structural policy to reduce inequalities, but disappears in the table of categories. The problem is that an important part of it is based on environmental actions which can be defended as European public goods. Then however, as higher co-financing rates are offered in poorer regions and some measures are not to be used in all regions, the policy becomes partially "redistributive" and partially a "European public good".

It is clear that similar policies should not be classified redistributive in regions falling under the Cohesion Policy, and be European public goods in wealthier regions. What to do then? This brings the issue nearly back to square 1, and calls for the elimination of the differentiation between redistributive and the public goods groups proposed, and also to abandon the idea that there is an intrinsic right for measures in wealthier regions to be financed by "real" own resources and not those in poorer regions.

Are the finance mechanisms proposed realistic?

The use of taxes for the European Public Goods section is laudable and more direct tax based resources should be pursued, even if member states will still resist the idea that any tax raised in their territory is European by nature.

What is unconvincing is the De La Fuente et al. (2008) financing mechanism based on fixed net balances for the "redistributive" policies. This would create massive distortions and would foster the invention of a number of measures to ensure that the net balances fit perfectly. With a smaller budget share consisting only of redistributive policies, there is a risk of the development of an even worse policy bundle as today, reinforcing, rather than weakening some of the existing tradeoffs, e.g. between CAP and Cohesion Policy, etc. This is well explained in the Notre Europe response. Wealthier member states receiving little CAP and little of the Cohesion Policy would fight for a return… if not for rebates of all sorts. With a clear distaste of member states in using direct transfers (see the preferred use of contorted VAT reductions and other complex cuts to net contributors), the predilection would be to introduce new complexities.

A very good proposal, however, is the increasing use of financial engineering mechanisms, such as loan guarantees for the EIB or the issuance of bonds. Just as an example, the loan guarantees from the EU budget of €500 million used to release EIB loans for the Trans European Transport Networks generates a twentyfold loan value. In addition, loans ensure that the budget is self-sustaining. Prudent use of financial instruments can enhance the reach of the budget and its effectiveness. Thus, the use of bonds for the "Capital operations" group, is a very good idea but it could also be expanded into other areas.

What to do with the budget?

If there is no clear cut separation between European public goods and redistributive policies, the proposal for this separation falls apart. It is unlikely that there will be an agreement on what should fall where, as the definition of European public good is not the same for everybody.

There are four points to retain from the paper which are important. The first is that the budget should focus its role in achieving EU objectives which generate a clear value to the European Union. The second is that the EU budget should not be used primarily as a transfer mechanism to poorer countries, regions and individuals (e.g. farmers). Third, that there are ways to enhance the reach of the budget using well known financial engineering instruments, such as bonds and loan guarantees. Fourth, that the decision making system has to ensure a stronger politisation of the budget by making the European Parliament have a stronger say on the budget, which is to a certain extent, achieved with the Lisbon Treaty provisions.

This does not mean that the Cohesion Policy or agricultural policy does not have a place in the budget, but that the way that they are used has to change considerably. We have rather important objectives for the EU to fulfil in terms of reducing greenhouse gas emissions, prepare for the impacts of climate change, restructure the energy sector, complete the internal market for energy, increase Europe's competitiveness and innovation capacity, increase justice and security in Europe and assist third countries to develop and adapt to climate change. The present budget only indirectly approaches those objectives.

Some reforms that are needed:

Contrary to Iozzo's et al. paper, it can be argued that a real reform of the budget startes by improving the policies rather than the budget structure and resources, except for the CAP, where a change in the way it is financed is necessary.

a) The EU budget should be used as a leverage instrument and not to fund any whole policy, which is the case of the CAP. The first reform, even without altering the CAP initially, is to use co financing of the CAP direct payments using a variable rate in line with the fiscal capacity of the member state and/or some other parameters (see Núñez Ferrer, 2008 for a description of such a mechanism). This would ensure that the EU budget is used appropriately as a solidarity instrument and eliminates the repressiveness of the policy.

b) The Cohesion Policy needs to focus more on European objectives in a coherent fashion. The EU's objectives are; improving Europe's competitiveness, a reduction in greenhouse gas emissions through an energy overhaul, improving sustainability and enhancing human capital. The present cohesion policy lacks a good framework, while the strategies of member states for the structural funds are often incoherent.

c) Research and Development needs to be more streamlined, more coordinated and well resourced, to fulfil EU competitiveness, energy and environmental objectives. It is important that the research undertaken with EU funds is also followed up, as there is evidence that once projects are concluded there is no follow up funding and assistance to implement any recommendations or develop, spread or commercialise any discoveries.

d) Energy and emissions: The EU has very great ambitions with important energy and climate objectives, but the budget is far from reflecting those ambitions. More coherence and more funding are needed to address this, funding better the Strategic Energy Technology plan, reinforcing the TENs in energy and rail transport, while better planning the use of other funds, such as cohesion funds for energy, waste management and land use.

e) Resources: On own resources, a reform is needed, but a move away from rebates could be achieved if the budget focuses more on European objectives than as presently. A co-financing of the CAP in the way presented in this paper and a refocusing of the EU budget to the major EU objectives and needs should improve considerably any negotiation to make the Own resource mechanism more transparent and introduce better resources, such as an energy tax. Even the UK would have to admit that strong links with energy policy and climate actions in the EU budget would weaken the arguments for a correction. The Emissions Trading Scheme (ETS), which accrues to member states, but is in fact a perfect candidate for a European tax resource by its characteristics, should partially or fully be used for emission reduction investments and adaptation, in the EU and in developing countries. It is not even necessary for it to be channelled through the EU budget. Introducing complex new automatic net balance and rebate mechanisms may actually ensure that member states lose their interest in the quality of the budget.

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