Reaction to Iozzo, Micossi and Salvemini, *A New Budget for the European Union?*[*]

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1. The analysis of the issues highlights many salient issues, for example the increasing divergence between the budget and the policy priorities of the European Union or the need to move away from net balance discussions.

2. It also rightly identifies that there is a need to address the governance issue, which includes the formal rules for adopting the budget as well as the informal processes currently in place, as these are inadequate for producing an efficient budget outcome. Maybe this could have been explored in greater depth as without a reformed decision-making mechanism, there is (and will be even if Lisbon comes into force) an inherent status quo bias which will stop fundamental reform of the EU budget.[1]

3. This also raises a more general question of how realistic a change to a three pillar structure is. Whatever their merits, these changes are probably unlikely to make it into concrete proposals at EU level as member states have a number of red lines which they will aim to maintain.[2] This does not mean that more ambitious proposals shouldn't be put forward but it is important to reflect on what can realistically be achieved now and what might be useful in principle but is unlikely to be implemented at this stage.

4. Turning to the specific recommendations in the PB, these can be summarised as follows: A three pillar structure, with the first focusing on redistribution (and based on a net balance approach), the second on public goods (financed mainly by genuine VAT own resources) and the third being Eurobonds to finance large scale pan European projects.

1 See for example http://ec.europa.eu/budget/reform/library/contributions/us/20080414_US_26_en.pdf
2 See for example http://www.epc.eu/TEWN/pdf/29000018_Bigger%20bang%20for%20our%20euros.pdf

Difficulties with categorisation

5. This structure is, from an economic perspective, clearer but the devil is in the detail. It is difficult to classify policies as either redistributive or as being public goods. Many argue, for example, that Structural Funds (which have been focused to a large extent on Lisbon Agenda goals) deliver public goods. Similarly, it can be argued that support for farmers can deliver public goods (food security, stewardship of the natural environment etc.) and so on. Also, why split agriculture support between the different categories (CAP market support and direct income to farmers), given that they aim to deliver the same objectives? Funding such as the EU Research Framework Programmes might also be distributed across different countries, implicitly containing a redistributive element. Even some of the capital projects will have both redistributive and public goods elements.

6. Whether or not these arguments are correct in identifying public goods, it is important to recognise that this reflects the point of view of many of the submissions to the budget review.[3] At the very least, this would mean that someone (who?) would have to go through the budget in detail to decide what falls in which category and this categorisation would then have to be accepted (unanimously) by the member states. You would then have to deal with issues such as redistributive and public good policies being financed by different pots but administered by one unit or even separate budgets for an activity and for the corresponding administration costs.

7. It is also important to discuss the question of what really are European public goods in much more depth. As argued elsewhere, a blanket decision to classify much of the EU's actions as proving public goods

3 Some of which are noted in this paper: http://ec.europa.eu/dgs/policy_advisers/docs/eu_public_goods_zuleeg.pdf

does not help to move the budget towards a stronger policy focus.[4]

Revenue/net balance

8. Even if such a categorisation could be done, it might end up with very few spending items in the public goods category (which will often be about the legal and administrative framework). Apart from the imbalance in the budget itself, it would also mean that the European surcharge on VAT would only pay for a small amount of what actually takes place at EU level – which would not meet the transparency criterion (citizens should be aware of what they pay to the EU budget).

9. Conversely, if there are significant budgetary items in the public goods category, convincing member states to ignore net balances will be almost impossible. It might not make much economic sense but member states will still insist on assessing how much is spent in each country.

10. Returning to the issue of governance, in terms of negotiations, member states would have separate negotiations on each pillar. But this is unlikely to happen as governments will take into account what is decided in one pillar to form their negotiation position in another (inevitably ending in an overall 'package' deal).

11. Having a general correction mechanism can also be difficult. For example, much of Structural Funds money spent in the new member states flows back to the old ones. Companies being supported with structural funds often operate across borders. It is almost impossible to construct a net balance system which makes sense in economic terms (rather than political ones).

4 Please see http://ec.europa.eu/dgs/policy_advisers/docs/eu_public_goods_zuleeg.pdf

12. This is aggravated by the fact that even spending on public goods will not be evenly spread across Europe and neither will the benefits. In a nutshell, for example a Single Market delivers many more benefits to a trade-oriented economy and transition costs for opening up markets will be highest where companies are most inefficient.

Third pillar

13. The capital project proposal in the third pillar might need to be explained a bit further. Is this a way for the Commission to borrow money or is it to make funds available more flexibly when they are needed for large projects? If it is borrowing, where will the repayment of interest and capital come from? If it is to provide more flexible funding where would the money come from and from which pot - the public goods or the redistributive one? Who would be the recipients of the money if not the Commission itself? If other actors receive more favourable conditions, who would pay for this? Is this compatible with state aid provisions?

Concluding remarks

14. The paper rightly identifies many of the issues which need to be addressed in the budget review, including for example, the overall structure of the budget, the juste retour issue, the need to provide more flexible funding at EU level and the balance between what is provided by the EU and the member states in terms of public goods.

15. The three pillar structure is an interesting proposal to overcome these issues but it is difficult to see how it could be translated into practice at this stage or who would have the incentive to push for such a new structure. In the context of the European budget review, to achieve progress maybe it would be worth focusing on some of the elements

proposed in the paper and working up more limited but implementable recommendations. For example, how to build in more flexibility to the EU budget or Eurobonds as a mechanism for the Commission to borrow to finance large scale capital project which require upfront investment.

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