A new European Budget?

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

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In their response to the Commission consultation on the budget review, summarized in the above mentioned CEPS Policy Brief, Alfonso Iozzo, Stefano Micossi and Maria Teresa Salvemini offer a diagnosis of the current weaknesses of the EU budget and propose a reform that they argue should improve the situation.

Their diagnosis is in most respects close to the one formulated by other analysts of the EU budget (e.g., Sapir *et al.*, 2003; Begg, 2004; Le Cacheux, 2005; Begg, Enderlein, Le Cacheux and Mrak, 2008), as well as by the Council, in the conclusions of its December 2005 meeting, by the EU Parliament in its 2006 call for a reform, and indeed by the Commission itself. It emphasizes the lack of congruence between the stated objectives of the EU and the current structure of the budget, as well as the apparent incapacity of EU authorities to agree on a better budget under the current decision-making and funding institutional setting. The paper also contains a critique of the net budgetary balance notion and of the importance it has taken in negotiations over the EU budget, which is, in many ways, close to the one developed elsewhere, with very similar implications derived in terms of general directions for reform of the financing side of the budget (Le Cacheux, 2005). The authors also take for granted, as most other commentators, that the current size of the EU budget –around 1% of the EU GNI, i.e. a little less than 130 bn euros in 2007—will not be changed, an issue on which we will return later on.

Their main proposals for reforming the budget fall under two headings: one is restructuring the budget into three distinct chapters; the other is introducing a new source of financing with the creation of European tax.

A new structure?

The authors propose to split the EU budget under three separate chapters, each with a specific source of financing: one grouping together those policies that essentially effect transfers between member states; the second one for European public goods' provision and financing; and the third one for capital operations. This separation is, according to the authors, with Musgrave's traditional classification of public expenditures under three major headings: allocation of resources, distribution, and stabilization. Though the latter is not explicitly mentioned by the authors, their third chapter, with its debt financing, might be seen as an embryonic tool for stabilization (see below).

Economists have always liked to distinguish functions, but analytical distinction does not necessarily entail functional separation in implementation. Of course, since Tinbergen, economists also tend to plead for a simple and efficient allocation of instruments to tasks in which each instrument of public intervention is allocated to the task which it performs best. Yet, in real life, it is usually the case that different instruments are being used simultaneously to pursue the same or different objectives, with a lot of confusion and probably not optimal efficiency. One may wonder why public budgets do not come anywhere near this ideal separation and allocation of instruments to tasks. There probably are good political reasons, maybe for the sake of opacity, or because targeting is not as easy as postulated by economists.

But let us assume that the EU, because it is more rule-prone and willing to listen to experts in its efforts to tame politically originated inefficiencies, adopts this distinction for its budget; several difficulties would still have to be overcome. One is the definition of European public goods: the authors tend to limit themselves to the current tasks addressed by the EU budget, whereas one may argue that other items should be included under their

second chapter, and while some of the items they put in the first one –aspects of CAP?--, or indeed in the third, also have attributes of European public goods. In short, and in spite of the recent efforts at clarifying this notion (Ecorys, CPB and IFO, 2008), the character of European public goods is not a purely technical one; it is also the result of policy choices: a clear illustration of this consists in comparing the list of European public goods in the CEPS Policy brief with the one hypothesized more than thirty years ago in the McDougall Report (EC Commission, 1977), or more recently in the study on the reform of the expenditure side of the budget (Ecorys, CPB and IFO,2008).

Suppose, for the sake of the argument, that member states agree on the list of European public goods to be included in chapter 2, the deeper question is then: why a chapter 1, at all? If those expenditures are purely redistributive, why should they be included in the EU budget, given the postulate that, for the sake of subsidiarity, the EU level should not interfere with national interpersonal distribution objectives. In line with the tenets of decentralization, if one wants to effect some interjurisdictional redistribution, for the sake of equalizing some measure of fiscal potential, for instance, then it should be carried out either by a system of formula-based, equalizing, "block grants", or even through the recourse to a progressive funding scheme, whereby national contributions would be calculated not proportionally to GNI, but with a progressive schedule, as proposed in Begg, Enderlein, Le Cacheux and Mrak (2008). Then, chapter 1 would be a simple fiscal equalizing scheme, and indeed net balance arguments would apply only to this part of the budget. In other words, expenditure items listed in chapter 1 could, in line with what had been suggested in the Sapir Report (2003), be renationalized, and the corresponding amount either subtracted from the EU budget, thus allowing for a reduction in its overall size, or reallocated to expenditures in chapter 2, as advocated by the Sapir Report.

With respect to chapter 3, the question, not raised by the authors, but maybe more pressing a year later, with the worsening of the economic crisis and the clearly inadequate response of fiscal policies in Europe, is that of stabilization. Of course, as emphasized long ago in the McDougall Report (EC Commission, 1977), in order to have a significant macroeconomic stabilizing impact, the EU budget would have to be larger, though maybe not that much larger if it contains well designed incentives schemes for national governments to perform the tasks agreed upon in common, in the spirit of a "Pigouvian federalism" (Fitoussi, Laurent and Le Cacheux, in Fitoussi and Le Cacheux, eds., 2007). But what the authors propose under chapter 3 and its financing could be regarded as a first step in this direction, as well as a –small-- breach in the balanced-budget rule.

Which European tax?

With arguments that closely parallel those advanced in a previous paper (Le Cacheux, 2007), the authors argue, after others (in particular, Cattoir, 2004; SGES, 2005), in favor of financing the expenditures under their chapter 2 –European public goods—with a genuine own resource, i.e. a new European tax. This makes sense, but the question is, then, which tax? They clearly come out in favor of a European VAT, with arguments in terms of neutrality, simplicity, transparency, and the like. Again, this emphasis on traditional public finance arguments is typical of economists, and may be defended on efficiency grounds. But it should be clear that the list of criteria to be considered when choosing a tax instrument for the financing of the EU budget is much longer than that (Cattoir, 2004; Le Cacheux, 2007, Begg, Enderlein, Le Cacheux and Mrak, 2008), and the weights to be attributed to the various items in that list are essentially a matter of political choice. It follows that other candidates should be considered and may well score better under a different ranking of policy preferences (Begg, Enderlein, Le Cacheux and Mrak, 2008). In particular, an EU corporate income tax would have some appeal, if one values the reduction in tax distortions and

the completion of the single market for firms. And a European carbon tax would clearly score very high on similar criteria, while in addition constituting also a very broad based instruments and making the financing side of the EU budget contribute to setting the right incentives for private agents to go in the direction of what may be regarded as the EU overriding policy priority, namely the fight against climate change.

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