Some responses to the comments

Stefano Micossi and MariaTeresa Salvemini

July 2009

Stefano Micossi is Director General of Assonime, Professor at the College of Europe and a member of CEPS Board of Directors.

Maria Teresa Salvemini is professor of economic policy at Università di Roma, La Sapienza.

Alfonso Iozzo , Stefano Micossi and Maria Teresa Salvemini are the authors of «A new budget for the European Union?», Policy Brief No. 159, CEPS, May 2008.

1. The debate launched by Notre Europe on its website on our contribution to the discussion on the EU budget reform (CEPS Policy Brief n. 159 of May 2009, "A w budget for the European Union?") has elicited various reactions (Begg, Le Cacheux, Pietras, Santos, Zuleeg and Notre Europe itself). While the discussion continues, we feel that some remarks on our parts may be useful at this stage to clarify our views and dispel some possible misunderstanding

2. We put forth four propositions, none entirely original, but in our view capable, if taken together, to place the discussion of EU on firmer analytical foundations and thus perhaps contribute to improved decision making. A fundamental objection to our approach (especially Begg and Pietras) is that there is no point in thus giving structure to EU budgetary decisions, which will always remain political and based on national interests; that the member states "will not be fooled" by procedural arrangements and will always negotiate on the basis of spreadsheets detailing the precise territorial distribution of costs and benefits of alternative revenue and spending proposals. If this view is accepted, of course the debate on EU budgetary reform becomes superfluous; the only meaningful discussion will be between the member states and concern the decision on total resources and their allocation to different spending chapters between the member states. Parliament and Commission will be irrelevant. The new decision making rules introduced by the Lisbon Treaty – notably the new powers attributed to Parliament and the abolition of the distinction between "compulsory" and other spending will also be irrelevant. Everything will be reduced to political expediency.

3. Our different view is that decision procedures count and can change negotiating incentives. On this there is a need to come to a clear position. Decision making procedures have been a fundamental component in building up the European Union that we have: there is little doubt that they have shaped policies, and that organized interests, not only the member states, have modified their ways of intervening in EU affairs following changed decision making procedures. This is an indisputable truth for all areas of Community action: from foreign policy and defense, to internal security, the internal market, commercial policy, competition policy and regulation, social policies. Why decisions on the EU budget should be left out of this logic and be shaped solely by general political goals of the member states, we fail to understand. Budgetary procedures also play a paramount role in shaping national budgets: countries with better procedures are likely to have better budgets both in the sense of allowing clear choices among competing priorities and improving the quality of revenue and spending patterns. If there is agreement on this principle, then we may usefully concentrate on designing rules that will bring about a better incentive structure than the one prevailing today, that obviously leads to inefficient outcomes.

4. For the sake of simplicity, we had decided to set aside the issue of the total size of the budget and mostly concentrated instead on its composition. We realize, however, that in practice the implementation of any meaningful reform of the budget structure may need to be "oiled" by an increase budgetary size – since it would be necessary to ensure a "Pareto" condition that no one should loose in absolute amounts. The dramatic events of the past year, with the unfolding financial and economic crisis, will perhaps make more palatable the prospect of an increase in the size of the EU budget – in view of a likely increased need for common actions for supporting the financial system and the economy. In this context, one can place the required changes in the structure of the EU budget within a suitably long transition period where the changed composition of the budget will come about gradually and leave no absolute losers – as was done in the past with agricultural spending. Within such an evolutionary approach, it

would perhaps be easier to agree on goals that undoubtedly require increased EU budgetary resources, e.g. for recapitalizing EU cross-border banks or promoting common environmental policies: activities that individual member states would not be able to undertake on a national basis, due to the presence of paramount territorial externalities, and therefore clearly qualify as European public goods.

5. Our procedural proposals boil down to the following four:

a) Unify all budgetary decisions in one five year budget decided under a unique procedure by each parliamentary legislation; the obvious purpose is to break the present pattern of segregated decision making for revenues and the different spending chapters, and bring all decisions together – under a single co-decision procedure between Parliament and Council, initiated by Commission proposals and concluded by majority voting in Council and Parliament – so that all the relevant trade-offs are considered unitarily.

b) Remove the issue of *net balances* from budgetary negotiations by agreeing on a rule whereby net transfers through the EU budget should be determined on the basis of ability to pay, based on the scheme developed by De la Fuente or other suitable schemes. Reference to a general principle of equity should not be so difficult to agree upon – given the clear inequity of present budgetary adjustments – and would have the paramount advantage that discussions on spending priorities would be less influenced by consideration of national monetary advantages. Of course, we are fully aware that other distributional effects of spending will remain on the table and that an overall balance of broad benefits will still need to be ensured: but one can hope that – once the immediate goal of getting more money for specific interests groups is removed from the table – distributional considerations will not prevail over those on the effectiveness of common programmes and the general quality of Community actions. In general, one should recognize that the attempt to slice every Community programme among the member states for distributional reasons has been one main factor reducing the effectiveness of spending programmes. We are also aware that the structure of net transfers will not entirely disappear from budgetary negotiations, since they will obviously influence member states' positions on total resources; but in that context they may be expected to play a role of second order, relative to the main decision on how much to raise for the EU budget.

c) Then comes our proposal to create separate chapters in the budget to distinguish "allocative" (public goods) and "distributional" activities, and create a new chapter for capital operations. The main criticism here concerns the difficulty of drawing the line between spending for public goods and redistributive payments between the member states. Of course, broadly speaking redistribution between the member states is a European public good, to the extent that it favors political acceptance of common policies and a general sentiment of solidarity – and for this reason we do not think that all redistributive policies should be renationalized; 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. In this sense, we qualify as redistribution all policies that imply a changed distribution of the costs and benefits of belonging to the Union and adopting the common policies. Production of public goods is everything else: all activities undertaken by the Union for common purposes that the member states could not achieve on a national basis. The redistributive implications of these policies are less important than their basic feature of common action for the realization of common purposes. Thus refined, our distinction between redistribution and allocation activities of the Union could be less difficult to implement in practice.

d) We have also proposed the creation of a separate budgetary chapter for the Union capital operations. True, this is a way to eliminate the constraint of budgetary balance year by year, although inter-temporal balance would be assured to the extent that the accumulation of wealth form common investments matched outstanding liabilities. This proposal does not seem to meet serious conceptual objections, only political ones that over time may fall as the need grows to mobilize substantial resources for common investment projects and offer the world adequate amounts of EU-bonds in support of the euro role as a reserve currency.

e) An question that has been raised in this context is whether the rule on net balances should apply to the overall budget or only to the redistributive chapter. In reality, our solution seems obvious since by definition the chapter for the production of public goods cannot be referred to this or that member state. It should also be recalled that according to present rules the net balances already exclude the traditional own resources.

f) Our fourth proposal is that public goods should be financed with EU own resources in proper sense – that is autonomously determined (by the EU Council) and accruing to the EU budget automatically without passing through national budgets. The reason is clear: once all relation to national budgets was eliminated, these revenues could be decided by EU citizens solely with reference to the expected benefits from the production of EU public goods. Of course, the GNI resource cannot possibly qualify, precisely because it is paid with a specific national budgetary decision and hence is by definition decided with sole regard to national interests. More in general, any tax autonomously assessed and collected by national tax authorities would not do, for the same reason. The only viable alternatives are taxes that can be autonomously accrue to the EU budget without national budgetary decisions or interference. In our view, this criterion excludes all taxes based on income, while many indirect taxes would qualify – including the VAT, that we tend to prefer (the argument that the VAT is regressive doesn't stand logically and empirically), a carbon tax linked to common environmental policies, or traditional own resources. As has been noted by Santos, the principle that different actions could be financed separately and differently in the EU budget dates back to the very beginning of European integration.

6. In sum, it seems to us that a meaningful debate about budgetary reform must be a debate about structure and procedures. Our proposals respond to clear needs to improve the efficiency of decision making and the incentives of decision makers. There are probably other ways to achieve the same results: these do not include a complete renationalization of revenues, as proposed by Begg and others in their Report to the EU Commission, which clearly runs counter the need to separate decisions on EU public goods from national budgetary decisions.

With the support of the European Commission
Education and Culture DG
'Europe for Citizens' Programme