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Summary

The EU budget always leads to intense debate and tough negotiations, yet its total amount represents only a very tiny share of aggregate public spending of the EU-25 and around 1 % of the GNI of the 25 member states. The EU budget is characterised by basically four points: a) the general structure of both revenue and expenditure sides has remained rather stable since 1988, b) the size of the budget is a permanent issue of debate and is actually capped by a ceiling, b) about 70 % of the expenditure has been allocated to just two areas: Common Agricultural Policy and cohesion policy, d) the funding of the budget has shifted towards direct payments from the national budgets of the member states. Under such conditions, the redistributive function of the EU budget cannot fulfil the expected positive role fully.

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I. Introduction

The EU budget always leads to intense debate and tough negotiations, yet its total amount represents only a very tiny share of aggregate public spending of the EU-25 and around 1 % of the GNI of the 25 member states. The EU budget is characterised by basically four points: a) the general structure of both revenue and expenditure sides has remained rather stable since 1988, b) the size of the budget is a permanent issue of debate and is actually capped by a ceiling, b) about 70 % of the expenditure has been allocated to just two areas: Common Agricultural Policy and cohesion policy, d) the funding of the budget has shifted towards direct payments from the national budgets of the member states. Under such conditions, the redistributive function of the EU budget cannot fulfil the expected positive role fully.

II. The redistributive effects of the EU budget

The EU common budget like any national budget has redistributive function, which is to serve common policy aims of the member states. One of the most important issues of the redistributive effects of the EU budget is how to set member states' fiscal balances in a manner that is consistent with equity criterion without sacrificing other economic policy goals.

Statistical and econometric analyses based on the relationship between per capita net budget balances (difference between transfers from and contribution to EU budget) and relative net GNP per capita across the EU member states have indicated that the net effect of the EU budget is redistributive. It means that on the one hand the net balances are on average positive in the case of the less developed or poorer member states and negative in the case of the more developed or richer countries on the other. In practical terms it indicates that for a typical citizen of a more developed or richer than the average EU member state, the net effect of the EU budget is equivalent to a flat tax of between 5 to 6 % levied on the difference between his or her gross income and the EU average. In the case of the citizens of the less developed or poorer member states the net effect of the EU budget is a transfer or subsidy of the same magnitude.

These figures of flat tax on the one and subsidy to the other are relatively very small compared with the degree of regional redistribution within any member state. The redistribution within a country is attained through the national budget and fiscal system and its size typically lies around 30% in the EU member states. Comparing the volume of EU budget expenditure, which is only around 1 % of GNP to the figures of national budget expenditures ranging between 30 to 55 % of GNP it can be stated that the EU budget is a rather effective economic policy instrument for redistribution among the member states.

Statistical time series show that the net expenditures of the EU budget have been distributed rather unevenly across the member states. A significant part (around 60 %) of the variation is related to the per capita GDP levels that is the poorer a member state is the larger the support given from the budget. Substantial deviations, however, indicate that member states having similar income levels are often treated differently. It means that there are member states which receive support from the EU budget meanwhile there are other member states of the same development category, which do not. The first experiences of the new member states underpin this fact, however thorough analyses cannot yet be done because of various reasons (lack of sufficient data, these countries joined the EU at the end of the out-going financial framework, etc.).

Regarding the main features of the evolution of the budgetary situation in a longer term some points can be mentioned. In qualitative terms there have not been many changes. The most

important modification has been the rather dynamic increase in the redistributive impact of the EU budget since the mid-1980s. This increase was more dynamic during the first 7 to 8 years than thereafter. The econometric analyses have shown that the arbitrary elements of the budget allocation increased until 1993 and have since decreased.

The redistributive effects of the EU budget derive from both its expenditure and revenue sides. Regarding the evolution of the budget, the expenditures have become increasingly progressive with the growth of structural spending. This expenditure item has heavily concentrated on the less developed member states and turned to be the most redistributive of all budget items. The functioning of the FEOGA of the CAP has also redistributive effects but only because the weight of agriculture employment is substantially larger in the less developed member states than in the more developed ones. Payments per farmer, however, vary substantially across countries and disfavour the less developed member states. As far as the revenue side of the budget is concerned, the contributions of the member states are approximately proportional to their incomes but the shares of sources of revenue are very disproportionate particularly in the case of VAT and tariffs revenues.

The overall redistributive impact of the fiscal flows across the member states is significant, given the relatively small size of the budget and they are brought about mainly by the structural and cohesion policy expenditures. The degree of redistribution increased substantially for the previous decades but was stagnating during the last decade. The distribution of net contributions across member states shows large and continual deviations from the longer term average pattern. The key question is what is considered as a fair allocation of fiscal costs and benefits. The existence of large surpluses and deficits is serious matter for concern and roots of recurrent dispute on the budget. The Commission's view is certainly true when it argues that in spite of the fact that the fiscal balances are the most visible and quantifiable factors, they can capture only a part of the costs and benefits of EU membership. As a consequence of it, public and government views on the general fairness of the budgetary system are likely to depend on the extent to which the redistribution is perceived to be reasonable and unbiased. An important issue is how the implementation of new mode of governance in the budgetary field can ensure that the budgetary and redistribution policy could obtain even wider public and government support within the EU.

III. The EU budget and the popular support

If the EU budget is an implementation instrument of common policy goals and policies then how can the Community bring the budget closer to the peoples of its member states it is intended to serve? Bridging the gap between the Commission and member states' governments on the one hand and governments and peoples would pose fresh challenges to the budgetary and redistributive process and policy. The Community needs to move beyond a mechanical conceptualisation and governance to one that recognises the relationship between policy, planning and implementation within a realistic functional framework. The Community needs to avoid the alienation that can develop with the growing gap between the EU and the peoples of its member states it serves. Two ways to bridge this gap is to strengthen the relationship and two-way communication with civil society and to develop processes that will enable political structures to directly, and strategically contribute to the development of the EU budget.

It is a common knowledge that rhetoric cannot replace reform. New processes must be institutionalised to ensure such engagements achieve their goals. This endeavour is already reflected in certain common policy areas, which calls for fresh forms of inclusion, consultation and

mobilisation which could effectively inform and influence institutions and policies including the budget which concretises policy for planned implementation.

The implementation and consolidation of the new mode of governance require the transformation of institutions of governance to ensure that it is capable of facilitating the pursuit of the new goals. This is also translated into good governance through the policy and process of deepening participatory democracy. Principles of transparency, accountability and responsiveness have driven a number of policy changes in institutional design and the development of enabling structures for good governance. Good governance requires the involvement of civil society including labour and business as well as other social partners in the decision-making.

Various political space and participation of member states' governments in the preparation of EU budget are the main characteristics of the present situation. How can those challenges be addressed which are arising from a non-homogeneous civil society which exists in the member states in a way that substantial part of their views is not distorted and/or diluted? It is an often mentioned point that where people are not involved in decisions that affect their lives, social policies and political interventions are less likely to succeed. Participatory democracy should therefore complement and enhance representative democracy. The question is how this should be addressed in details in the case of the EU budget. In the context of new mode of governance and participatory democracy, political space creates a natural opportunity for greater participation in the preparation process of the budget. It is not necessarily optimal if technocrats only draft the budget without being influenced by a political policy process. A further related question is how the capacity of all legislatures can be strengthened to examine and assess the allocation of resources to achieve the stated targeted results?

EU budgetary policy must support the development of the member states and the implementation of the common policy goals of the EU member states. The direct goals of the budgetary policy like in the case of all community policies must be subject to regular review in terms of its impact on the overall objectives of the community policies. It is often impossible for the public to appreciate the purpose of expenditure and the achievements of the objectives.

IV. Some reform issues

The reforms of the EU budget over the last decades have often striven to ensure greater political intervention of member countries' governments. Thus, the question is how the public can effectively participate in the preparation of the budget in terms of determining policy priorities for implementation and alerting to new developments, which can be incorporated into the budget. Related issues are first, how public awareness and understanding can be increased of both the current and long-term implications of the budgetary situation and second, how enhanced opportunities for public input can be created to budgetary and redistributive decisions.

The question of the appropriate level of centralization and decentralisation of budgetary policy can be also addressed. The main points are the assignment of competency to tax, spending and regulatory responsibility to the various spheres of governance and the interface with the private sector and civil society. This framework should assign responsibility to that sphere of governance at which the delivery is optimal. It is obvious that the decentralization of the budgetary policy of the EU is not necessarily always better than centralization. A further centralisation of certain elements of budgetary and redistributive policies in the EU would be indeed preferable. The likely optimal solution is that centralisation and decentralisation processes should take place at the same time but in different areas.

Sub-community governance levels often pursue "self-interest" policies and strategies seeking a "free-ride" with no accountability that undermines community unity. The principle of co-operative governance containing elements of centralisation is an essential catalyst to overcoming this problem. This principle and collective principle act as a countervailing weight to the "beggar-thy-neighbour" policies. The accessibility of information, which is related to the third important principle, that is the principle of transparency, is not only necessary but also an essential requirement for effective oversight by the legislatures. If social and economic partners, civil society and labour are to effectively contribute to the development of the policy priorities in the budget then access to relevant information is an imperative.

What is needed is to facilitate fiscal harmonization and stabilization and stability checks. The advantages of a community level budget should be successfully merged with the advantages of fiscal decentralization in an effective intergovernmental fiscal system. It has to be kept in mind that one of the effects of globalisation is the increasing impacts on the designs of fiscal systems in a globalised world economy. These impacts can prevail more vigorously in the integrated European economies.

Any budgetary system of good governance requires not only political will but well-functioning common or at least harmonised accounting and financial management and tax systems and also adequate information systems. Regular reviewing of EU budget policy priorities and ensuring an engagement with lower levels should be the main features of a political policy dialogue and not a one way street of instruction. It implies a change in the instruments of budgetary management but also a change in the style and mode of governance. The changes should lead to larger budget integrity, greater transparency and increasing accessibility. Changes in managing the budget should concern the rules of procedure and position that are introduced to transform the behaviour of those involved as well as the redistributive function of expenditure.

The needs to change are set off by various issues, problems and questions. What should be the EU's spending priorities and how much should it be spending in total? How might the main current areas of spending be reformed? The EU's latest enlargement has brought these matters to a head, but arguably a serious debate about the EU budget is long overdue. The fact that this discussion is taking place after the entry of ten new member states rather than before is only likely to increase the problems of reaching agreement.

The practice shows that the main objective of EU spending is to achieve acceptable net balances rather than agreed policy objectives. The larger net contributors, which belong to the group of more developed member states, press hard for a reduction of their net contribution, while the less developed member states argue that their positive net balances should be preserved on equity grounds. Disparate national interests are also clearly evident in the opinions on the proposals for the restructuring of farm and structural programmes and British rebate. Besides these conflicts between national interests, one of the most critical obstacles to a budget consensus is the absence of a shared and operational equity criterion for the redistribution of net budget contributions.

V. The main points of a new mode of governance

On the basis of experience of the current budget system and several theoretical arguments there are some crucial issues and points, which should be taken into consideration when a new mode of governance is designed and evaluated for the redistributive or budgetary mode of governance:

- 1) Net EU budget contribution (balances) should be linked to income per capita through simple rules that reflect an evolving consensus on the desirable degree of redistribution and treats member states with similar income levels in a similar way.
- 2) The budget items should be evaluated in terms of the policy goals and not their redistributive effects. But taking into account the principle of cohesion, the overall distribution of net benefits should be inversely related to income levels.
- 3) The new mode of governance of the budget should provide a transparent way of implementing the principle of cohesion without sacrificing other policy objectives. It should reduce the scope for real and perceived inequalities in the redistribution of budget resources. The system should be based on such operational principles that the member states (government and its social partners) need to negotiate over a single, easily understandable and interpretable parameter and not over a list of specific items that may lead to obviously arbitrary distribution.
- 4) New procedures should be introduced which can change the incentives faced by member states governments. The changes should include that the overall spending targets for each programme, which are now largely set in advance, should be loosened up. The importance of horizontal programmes should be increased because their impact on member states' net balances cannot be measured exactly in advance.
- 5) The new mode of governance of the budget should increase the role of the social partners in the member states and reduce that of the national governments in the decision making process and the implementation process of the budget by different means. An additional important issue is the decoupling of national contribution to the EU budget from the national budgets (e.g. direct European taxes).

The EU failed to achieve a reform of the budget system during the negotiations over the Financial Perspective for the period 2007-2013 but there will be a possibility to do it in 2008-2009 when the budget policies will be reviewed. The EU should go the whole way and introduce a transparent redistributive system that is not linked to EU policies. Its main objective should be a simple one, namely to achieve a fair and politically acceptable financial burden sharing and redistribution of financial benefits and contribution. The principle of new mode of governance can provide substantial guideline to achieve this end.

VI. Further Reading

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