Reforming the EU budget to support economic growth

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Abstract

The Euro crisis has dragged on now in March 2012 for the best part of two years. The emphasis has been on imposing austerity in indebted countries in return for loans from the Eurozone member states and the IMF. A new treaty on fiscal rectitude has been negotiated outside the European Union between 25 EU member states. This emphasis on austerity is particularly interesting given that only in the case of Greece was fiscal irresponsibility the main cause of the crisis. It is quite obvious that fiscal responsibility must be an essential ingredient in each member state of the monetary union if future disasters are to be rendered less likely.

The problem with austerity is that it is essential for the medium and longer term but it can kill you in the short term. Without economic growth the weaker indebted Eurozone members cannot get out of their current indebtedness. In the European Council the policy emphasis is therefore gradually turning towards ways of stimulating economic growth, although Germany, the Netherlands and Finland still put the greater emphasis on fiscal retrenchment.

While there is general consensus on the importance of generating growth in the European Union, the levers which can be used are not numerous and not obvious. In this climate many member states have turned their attention to using the European Union's budget to support economic growth in spite of the fact that the total annual budget is only around 1% of EU GDP.

Currently the member states are negotiating the multiannual financial framework which covers the seven years from 2014-2020 (MFF 2014-2020) and the search for both efficiency and for economic growth stimuli have figured in the discussions in the Council.

This working paper considers the scope for making the EU budget more supportive of economic growth. It concludes that while this aim is totally feasible, the politics of the EU budget are liable to condemn the MFF 2014-2020 to being extremely similar to its predecessor.

Reforming the EU budget to support economic growth

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'At the time of a crisis, the EU budget should become an investment tool significantly contributing to EU economic growth.'

This quotation comes from the programme of the Polish Presidency in the second half of 2011. But is the aim of the EU budget really to support economic growth? There is no specific mention of this objective in the EU treaties, which consider the objective of the EU budget simply to be the financing the EU's aims and policies. However in the aims of the European Union in article 3 (TEU) economic growth figures significantly.

Much of the academic debate on the EU budget has however concentrated on the perception that it supports declining sectors in the European economy rather than stimulating expanding sectors and technological development.

This paper examines the extent to which the Union's budget does support economic growth and makes suggestions for how it could be used to finance policies which would foster this objective.

A. Background considerations

1. Introduction:

The European Union's budget is one of the most studied and discussed elements of the European Union construction. And taken together with the Multiannual Financial Framework (MFF), EU finances are the most contentious and hard fought-over elements of EU policy.

This is from one point of view astonishing because the European Union budget is an extremely small part of EU GDP.

However it is not at all surprising if one considers the EU member states as taxpayers financing the budget of a higher level authority. The scope for lengthy negotiations is clear.

The Treaty on the Functioning of the European Union (TFEU) in its Title II on financial provisions establishes the procedures for agreeing both the annual budget and the MFF. The MFF is decided by unanimity in the Council and, since the entry into force of the Lisbon treaty, the European Parliament must give its consent by a majority of its members. Unanimity clearly gives each member state an extremely strong bargaining position in the negotiations on a new MFF. Net contributors have every incentive to block any increase in the overall level of the medium-term budget, while net recipients of EU funds have a reasonable chance of ensuring that their net receipts remain largely intact. The result is an MFF negotiation which usually lasts for not far short of two years and generates a great deal of disharmony among the member states.

There are a large number of studies which propose major reform to the EU budget. Some of these start from a clean sheet of paper, others from the structure of the current budget. These studies usually identify 'juste retour' as a major obstacle to reform of the budget and to the design of EU policies. On the expenditure side of the budget many of the studies propose radical changes, usually criticising the share of the budget being spent on a low productivity sector, agriculture, and on the lack of concentration of funds in cohesion policy. These studies are usually based on the theory of fiscal federalism and are extremely valuable in suggesting ways in which EU finance could support economic growth and the development of key policies in the European Union.[1]

Unfortunately these studies have often been ignored by policymakers in the member states and frequently do not find support amongst the members of the European Parliament. A combination of the logic of 'juste retour', elements of pork-barrel politics and the rigidity of the Treaties have generally lead to path dependency dominating the budget and the MFF.

It is certainly true that criticism based on the theory of fiscal federalism and on the need for structural change in the European Union has had an effect on EU budget outcomes. The MFF 2007-2013 increased the amount of finance for research and reduced expenditure on the Common Agricultural Policy as a percentage of the total budget**.** The European Commission in its draft MFF had proposed far greater changes to make the budget more supportive of research, innovation and economic growth. In spite of the fact that the member states finally agreed an MFF which was not radically different from the previous MFF, they did accept certain changes which marginally made the budget more growth friendly.

The European Commission's proposal for the multiannual financial framework 2014-2020 contains only very marginal shifts in spending categories.[2] The proposal is framed in the light of the current economic and financial crisis and the need to conciliate the net contributors and the net beneficiaries. But one main objective of the Commission was almost certainly to avoid the Council radically changing its proposal.

In this study of how to make the European Union budget more supportive of economic growth, an attempt is made to propose ways to optimise the growth elements in the budget subject to the constraint of political feasibility. The study begins with introductory remarks on the purpose and nature of the EU budget. A consideration of the theoretical grounds for financing from the EU budget is followed

[1] The most widely read and most influential such study, which is often referred to as the 'Sapir report' after its chairman, is entitled 'An agenda for a growing Europe, making the EU economic system deliver', European Commission, July 2003.

[2] European Commission, A budget for Europe 2020, COM (2011) 500, June 2011.

by a discussion of the determinants of economic growth and the main EU policies affecting growth. An analysis of the current EU budget is undertaken as a prelude to section D which proposes a budget which would support economic growth. Section E discusses the political constraints on reform of the budget and the final section suggests some improvements which might be negotiable in spite of these political constraints, some of which are reflected in the Commission's proposal for 2014-2020.

i. What is the purpose of the European Union budget?

This question is made more complicated by the fact that the European Union is a unique organisation, in which its constituent member states also have different views on its aims and objectives. For some member states the aim is clearly political union in Europe while for others it is little more than an internal market. The budgetary logic of the integrationist countries would be that the EU budget should be considerably larger than its size today and should undertake some of the functions commonly performed by federal governments. For those member states which regard the EU essentially as an internal market there is little point in an EU budget except to finance institutions necessary to regulate the internal market.

The Treaty does not help us very much either to answer this question. Article 311 TFEU tells us simply that 'the Union shall provide itself with the means necessary to attain its objectives and carry through its policies. Without prejudice to other revenue, the budget shall be financed wholly from own resources'. Article 310 adds the important sentence that 'the revenue and expenditure shown in the budget shall be in balance', thus excluding the possibility of budget deficits or surpluses. The remainder of the Treaty articles dealing with financial provisions outline the relationship between the annual budget and the multiannual financial framework and the way in which decisions should be taken on both instruments.

However, article 311 does tell us that the fundamental purpose of the budget is to finance Union policies.

Not all EU policies are designed to stimulate economic growth or deal with economic problems, yet they have to be financed. Typical here are those policies which deal with internal security and border management or many elements of foreign policy including development policy. The Treaty principle that 'the budget shall be implemented in accordance with the principle of sound financial management' naturally also applies to these policies, but this is clearly not related to the debate about the budget and economic growth.

EU policies are geared to realising the aims of the European Union which are now set out in article 3 of the Treaty on European Union. These aims include both mainly economic aims such as the creation of the internal market and the establishment of an economic and monetary union as well as principles which have both an economic and a moral foundation such as 'economic, social and territorial cohesion, and solidarity among member states'. The EU budget is expected to finance EU policies related to these aims irrespective of their relation to economic growth.

The EU budget can therefore not be judged entirely from the perspective of whether it stimulates economic growth. However economic growth is fundamental to the strengthening of the European Union and its ability to realise its aims and function according to its principles. This is especially true as the European Union recovers from an extremely deep recession and has to prepare to meet severe long-term additional costs arising from the demographic situation and from an increase in the competition for world resources. There is every reason therefore to seek improvements in the European Union budget which would make it more supportive to economic growth in the future.

The aims of the European Union, set out in article 3 TEU, are to be achieved through EU policies. The budget of the Union, as the Treaty says, serves to reach the objectives of the Union through the financing of EU policies. It therefore appears to be fairly straightforward to allot budget finance to individual policies.

The problem is that the EU has so many second level objectives and such a large number of policies that, given the size of the EU budget, it is totally impossible to finance all of them. Therefore implementing an EU policy or serving the aims of the Union may be a necessary condition for financing from the budget but it cannot be a sufficient condition.

In the Europe 2020 policy as an example, the Commission proposes a very large number of policy objectives associated with an even larger number of actions. Admittedly not all of these actions are to be carried out at the EU level. However in just one flagship initiative in one policy area – ‘resource efficient Europe’- there are eight initiatives which are to be taken at the EU level covering a very wide area, from completing the internal energy market to modernising and decarbonising the transport industry.

ii. The European Union budget and EU-wide public finance

The European Union budget is a very small part of public spending in the European Union - it is at most 2.5% of total public spending. In spite of its small size it is the subject of more criticism than most national budgets. This criticism is often based on the assumption that the EU budget is a normal national budget like those of the member states.

This is clearly not true. The EU budget is restricted to financing EU policies and those policies cover only a limited part of public sector activity in the Union. Indeed the largest elements of public spending in the member states, social welfare, education and defence, are barely represented at the EU level and in the EU budget.

It is more useful to regard the EU budget as an extension of national budgets. It deals with those areas of European Union policy, where the European Union has decided to finance policies centrally. By no means all European Union policy is financed from the EU budget. Policy may be decided centrally but financed by the member states in their national budgets. This is the case for instance in policies which attempt increased coordination in economic policy. The Europe 2020 programme, aimed at structural reform in the EU economy, was decided centrally but the actions involved are often the responsibility of the member states, and, where finances are involved, will be financed by the member states. However in the case of cohesion policy for instance, the European Union has decided to support the development of relatively poorer areas of the Union directly through the European Union budget. In the case of the Common Agricultural Policy, the member states have decided to provide agricultural subsidy through the European Union budget rather than through national budgets, although there is nothing in the Treaty which suggests that financing should be organised in this way.

It is therefore not necessarily valid to criticise the European Union budget for concentrating heavily on agricultural subsidy. Member states have simply decided to centralise spending on agriculture rather than for each member state to have its own substantial agricultural subsidy budget. Although agricultural spending still makes up around 40% of the EU budget, total agricultural spending across the whole of the EU is only between 1% - 2% of public spending. These facts do not make the subsidisation of agriculture any more justifiable but they do explain that the EU budget should be seen as part of overall EU public expenditure.

iii. The EU budget is small but can have significant leverage on other sources of finance for economic growth

The EU budget for 2011 amounted to €142 billion in commitment appropriations and €126 billion in payment appropriations. Payment appropriations amount to 1% of EU GNI. It is clear that reform of this rather small proportion of Union public spending is unlikely to make a big difference to overall economic growth.

However EU budget funds could potentially have a more substantial impact on economic growth for two main reasons:

- EU budget funds can be more easily directed at areas of policy which are known to impact significantly on longer-term economic growth such as research and innovation
- EU budget funds can leverage considerable funding from the private sector or from national state budgets thanks to the financial quality of the EU budget and the reputation of the EU

The very limited size of the EU budget makes it totally unsatisfactory for the purpose of redistribution or to support consumption. These are tasks for which the far larger budgets of the member states are appropriate.

The EU budget is far more appropriate for supporting sustainable growth through investment in European public goods, research and innovation, for the purpose of enhancing the quality of the labour force through training and education, and for leveraging investment in infrastructure. Sustainability must be a criterion for the allocation of budgetary funds to ensure that they support economic growth also in the longer term.

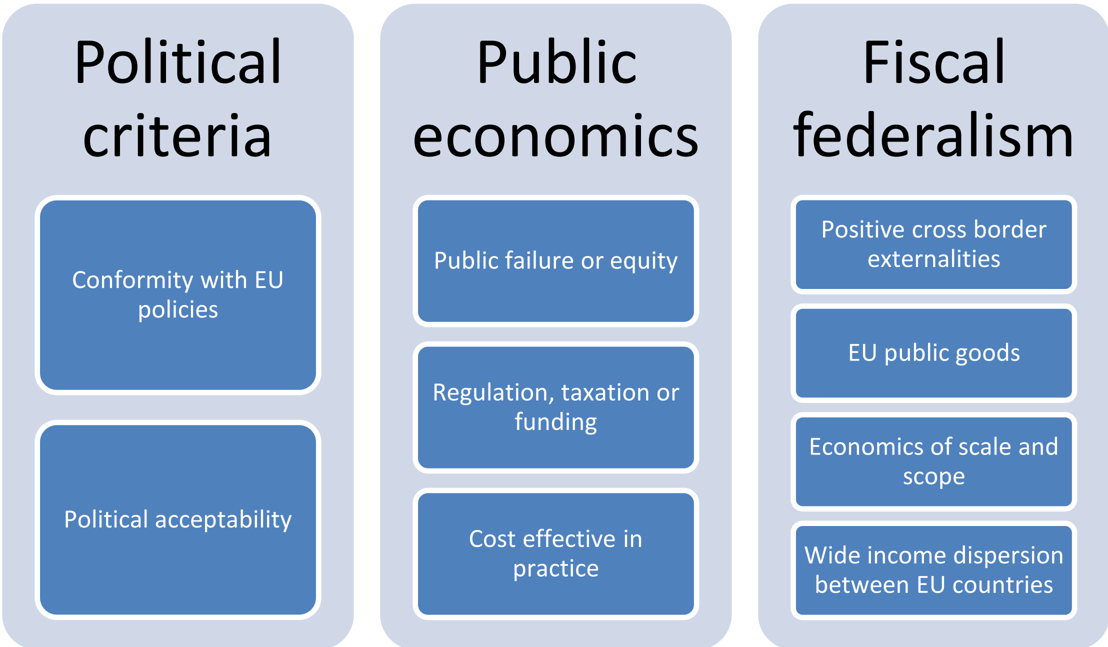
The small size of the budget also calls for particularly innovative techniques in the execution the budget, in order to generate far greater investment from the private sector for a relatively small public contribution.

2. Theoretical basis for budget intervention:

The theoretical basis for budget intervention has been rehearsed many times in the literature. [3] It is taken fundamentally from the theories of public sector economics and fiscal federalism. Respect for the principles derived from the theories would lead to the budget increasing its support for economic growth and therefore need to be kept very much in mind in this study.

The criteria for EU funding have been neatly summarised in a diagram in the Copenhagen Economics paper 'the EU budget review, options for change' published in June 2009:[4]

Figure 1: Criteria for EU funding (source: Copenhagen Economics 2009 – after Figueira 2008)



Public economics and fiscal federalism arguments tend to overlap in the context of the EU budget.

The key reason for governments to intervene in the functioning of the market is either to correct for market failure or to aim at creating a more just distribution of resources. The main sources of market failure are the existence of public goods, externalities, the concentration of market power and information distortions.

The provision of public goods and the existence of externalities are important criteria for EU intervention. Typical here would be measures against climate change which benefit all, the operation of pan-European Union institutions or the protection of the

[3] One of the most detailed discussions is to be found in 'How to reform the EU budget? A methodological toolkit' by Filipa Figueira, Swedish Institute for European Policy Studies 5:2009.
[4] Coperhagen Economics: EU Budget Review: options for change. Copenhagen, June 2009.

external frontier of the Union, where the cost falls on particular member states but the service benefits all member states. An interesting example of funding in the light of externalities is the 'European Globalisation Adjustment Fund '. The aim of the fund is to help the retraining of workers who risk losing their jobs because of changes in production and trade patterns, which themselves are considered positive for the European Union as a whole.

The concentration of market power through increasing returns to scale can lead to the creation of monopolies which lead to inefficiencies and to price distortions in the market. This is the justification for the existence of competition policy at the EU level. This intervention by the Union requires no or very small budget support, as the Union has chosen to use regulation rather than budgetary finance to tackle the problem. Indeed the recent history of the Union shows that regulation is being used more frequently to solve problems of market failure.

Information deficiencies or asymmetric information also distort the market, potentially leading to inefficiencies in supply and demand and potentially to moral hazard. This can justify governments and the European Union taking measures to improve the supply of information and thus avoid these asymmetries and distortions.

Governments trying to deal with market failure can choose between appropriate regulation, taxation and funding. At the EU level it is really only regulation and funding which can be used and the choice will depend on the characteristic of the problem. Regulation is clearly more appropriate in dealing with many environmental problems especially transborder pollution. However funding would be more appropriate in the case of an EU wide service provision, the cost of which fell on one or several member states. This is appropriate in the case of integrated border management. However interventions by government must be cost effective; public sector overruns in cost are only all too common.

While the arguments derived from public sector economics have general application to the European Union budget, fiscal federalism theory deals with the division of responsibilities between the various levels of government in a situation of multilevel governance.

Externalities and economies of scale, which are two reasons why public sector economics suggests that government intervention may be appropriate, also figure in the fiscal federalism arguments. Externalities, both negative and positive, might suggest that the EU should manage policy rather than individual member states. At the EU level the externalities can be taken into account in designing the policy. Economies of scale may also suggest certain areas of policy being undertaken at the central level. This is a frequent argument used to develop research policy at the EU level rather than having small research centres in several different member states all basically researching the same problem. However if different member states have very different preferences there may be an argument for keeping policy at the national level.

The economic arguments which essentially aim at producing efficiently operating markets are however constrained by two principles of EU policy: subsidiarity and proportionality mentioned by Figueira in her 2009 paper.[5]

The subsidiarity principle suggests that action should be taken at the EU level only when it can be shown that this would be more effective than action being taken at the member state level. This obviously does not apply legally to the areas of exclusive competence of the Union. To a certain extent this argument is linked to the EU value-added criterion which is often applied in debates about whether new policy should be located at the EU level or at the member state level. A large number of Council texts mention EU value-added as an important measure also for budgetary allocations.

Proportionality implies that action taken at the EU level should be limited to what is necessary to achieve the objectives of policy.

Government also has a role in ensuring a degree of equity throughout its territory. This can be justified basically from a moral perspective but there is also a body of scientific literature which suggests that economies with a more equal division of incomes and wealth tend to perform better than those with extreme distributions. In the case of the European Union, cohesion and solidarity are written into the Treaties. Cohesion is expressed in various ways but notably through significant transfers from the EU budget.

There is some dispute about the equity role of government in a multilevel governance situation. In the economic growth context some economists would maintain that investment in the most developed areas of the Union would lead to much faster growth than supporting investment in the weaker areas of the Union. There is also a problem where member states refuse to implement policies of structural change which would improve their economic outlook and therefore remain recipients of transfers. Nevertheless there is general agreement within the European Union that the structural funds are a desirable and necessary part of the EU budget. That being said, there is a great amount of discussion about how to use those structural funds in a way which supports faster economic growth.

The somewhat theoretical arguments raised in this section give some guide to what should and should not be financed by the European Union budget. However, as in most areas of policy, these arguments are insufficient to determine the structure and size of the European Union budget. It is not completely clear for instance what is and what is not a European public good and the principal of subsidiarity is not only difficult to interpret in detail but may run counter to the principal of solidarity or other fundamental values of the European Union. Theory is therefore important but cannot ultimately be the only determining factor in the EU budget.

3. The fundamentals of economic growth

Finally in these background considerations, it is necessary to consider what are the main drivers of economic growth.

[5] See footnote 3.

The main drivers of economic growth are essentially changes in the amount and quality of labour and capital inputs together with technological progress. These factors are addressed in the Europe 2020 programme, whose aim it is to accelerate economic growth through structural change in the European Union. However many of the actions required to meet the Europe 2020 aims are the responsibility of the member states rather than of the EU.

The explanation of differences in economic growth between industrialised states has been investigated by the OECD on a regular basis since the publication of its study on 'Understanding Economic Growth' in 2004.[6] It now publishes annual 'Going for Growth' reports which investigate different elements of the 'growth differential' story. While it is clear from these reports that there are a vast number of different elements which impact on economic growth, certain elements stand out as being particularly significant.

The size and quality of the workforce is quite clearly important in the explanation of differential economic growth. The Lisbon agenda, and its successor Europe 2020, both emphasise the importance of increasing the size of the labour force through rising activity rates, and some progress has been made in this respect. However perhaps of even more importance is raising the level of skill and technical competence of the workforce through improved education and training. This is an area where the European Union and the EU budget have a role to play, even though education and training is essentially a competence of the member states.

Investment in productive capital is vital for maintaining Europe's growth performance. But here macroeconomic policy and open and competitive markets domestically and at the global level are the key factors in persuading the private sector to increase productive investment. However public investment also remains an important element in stimulating growth in the economy. During the recession and the subsequent efforts to tackle the fiscal deficit, public investment has tended to be severely cut, as governments attempt to rein in public spending. However there is a role at the European level to stimulate public investment particularly to encourage the physical integration of the different infrastructure networks and systems in the Union. The trans-European networks are a key factor in integrating the internal market of the Union and the economic space with our neighbours.

Advancing technological change in the European Union through an emphasis on research and innovation will be a key factor in promoting economic growth. Technical change is of course embodied in new investment undertaken both in the private and public sectors. Disembodied technical change however has also been an important factor in economic growth and is closely associated with the development of the IT industry. The European Union has a role to play in supporting collaborative research and development in science and technology as well as in promoting innovation and the diffusion of knowledge and experience in the use of new technology throughout the Union.

In consideration of how the European Union budget could be used to stimulate faster economic growth, these main explanations of economic growth need to be kept in

[6] OECD, Understanding Economic Growth, Paris, 2004.

mind. However the Union has a more direct impact on these elements through the operation of the structural funds, financed from the EU budget. In its management of the structural funds, the previous Commission already laid emphasis on ensuring that the member states in receipt of structural funds used them in a way which furthered the objectives of the Lisbon Agenda. This earmarking, now to the Europe 2020 programme, should obviously be continued into future multiannual financial frameworks.

Conclusions from theory

This initial consideration of the background to supporting economic growth through the budget suggests the following conclusions:

1. The keys to accelerating economic growth lie in:
    a. the size and education and training of the workforce
    b. technological advance based on research and innovation and
        i. embodied in increasing investment
        ii. or disembodied leading to increases in multi-factor productivity
    c. and stability oriented macroeconomic policy

2. While the EU budget exists to finance EU policies, financing through the EU budget should also as far as possible concentrate on financing European public goods and tackling market failure.

3. Financing should be subject to the principles of subsidiarity and proportionality, to ensure that EU budget funding achieves EU added value and avoids wasting resources

4. The EU budget exists to finance EU policies, some of which have nothing to do with supporting economic growth and may even impair economic growth. Therefore any reform which aims at supporting economic growth will only really impact on a proportion of the total budget, although given the predominance of economic policies in the EU, this will be by far the larger part of the budget

5. Reforming the EU budget to make it more supportive of economic growth is important although it will not substantially affect overall growth in the Union because of its small dimension. The budget can however add significant leverage effects which will encourage growth in the overall economy.

6. Realistically the political economy of the EU budget suggests that reform will be limited by the capacity of member states to resist any changes which negatively affect their financial position.

B. EU policies and economic growth

From its very beginnings the European Union has essentially been about ensuring a high standard of living for citizens through the maintenance of macroeconomic stability, the creation of an internal market with factor mobility and the promotion of an open world trading environment; that is to say it has been about economic growth. It is true of course that the ultimate objective of its founding fathers was political union achieved through economic union.

These essentially economic policies dominated the development of the Union up until the end of the 1980s, when the Communist system in Europe collapsed and other less economic issues climbed up the Union's agenda. However through the financial crisis and the ensuing recession, it has once more become apparent that economic integration is the key to further political integration in the European Union and perhaps to its very survival.

Four key economic policies form the heart of economic integration in the Union: economic and monetary union, the deepening of the internal market, structural adjustment programmes and especially Europe 2020, and cohesion policy.

Economic and monetary union is of course a key policy of the European Union but it is one which does not, at least at present, create a serious direct charge on the EU budget. However the EU budget is used as a guarantee for part of the Eurozone rescue package; the European Financial Stabilisation Mechanism (EFSM).

Indeed the role of the EU budget as a guarantee instrument is frequently overlooked. Apart from the €60 billion of loans from the EFSM, the budget also guarantees €50 billion of medium-term balance of payments assistance. These guarantees have no impact on the EU budget unless there is a default amongst the borrowers. However as the likelihood of a restructuring or even further haircuts of the debt of some Eurozone countries increases, this is an area to at least be aware of.

The deepening of the internal market, especially in the services sector, is at the very core of any programme which aims at stimulating faster economic growth in the European Union. The incompleteness of the internal market, especially in the services sector, represents a major economic growth reserve, which, given the political will to act, could raise EU growth rates by a substantial amount.

However, in essence, the development of the internal market is a regulatory policy rather than a policy which involves major budgetary financing. Small amounts of money are involved in the management of the internal market, in terms of staff, research and development, legal advice, meeting costs and other essentially administrative tools, but these are not substantial costs in the terms of even the small EU budget.

The programme of structural change in the European Union, the Europe 2020 programme, is a further key to accelerating economic growth in the Union and it potentially could have significant impact on the EU budget.

Europe 2020 is built around three main concepts:[7]

- *smart growth*, developing an economy based on knowledge and innovation

[7] European Commission, Europe 2020, a strategy for smart, sustainable and inclusive growth, (COM (2010) 2020, 3.3.2010 Brussels.

- *sustainable growth* promoting a more resource efficient, greener and more competitive economy
- *inclusive growth* fostering a high employment economy delivering social and territorial cohesion

The programme is a vast collection of aims and objectives, actions, flagship initiatives and various other measures, some of which should be tackled by the European Union and its institutions and some by the member states. It has been criticised for not prioritising sufficiently but its merit is that it provides a list of actions, which are designed to accelerate economic growth. It has therefore become a checklist against which other policies in the European Union, including cohesion policy can be measured. It is therefore worth analysing the key elements of Europe 2020 when considering future budget financing in the EU.

It should be noted that more structural reform has been implemented or planned due to pressure from the Eurocrisis than was achieved in over a decade of the 'Lisbon Agenda' and 'Europe 2020'

'*Smart growth'* consists of activities designed to increase the percentage of European GDP spent on research, promoting innovation and the transformation of research outcomes into business opportunities, raising the quality of education and training and developing Europe's digital infrastructure and technology. Each one of these sets of activities is associated with a flagship initiative.

The aim of the EU level in this area includes the further development of the European Research Area and the encouragement of collaborative research throughout Europe, the promotion of mobility of researchers, teachers and students and the creation of a single market for online content and services together with the necessary legislation at European level to stimulate investment in high-speed internet infrastructure.

It is true, as mentioned above, that the role of the European Union in smart growth will include the creation at European level of the necessary regulatory framework for structural change in research, education and digital fields. But there is already considerable expenditure through the EU budget in this area and it is considered to be a priority for the future. However it is important that this expenditure is justified under the criteria discussed in the first part of this paper.

'Sustainable growth' is essentially about investment, which will support economic growth not only in the short term but in the medium and longer terms. It concentrates on improving the competitiveness of European enterprises and the capacity of the Union to improve its relative competitiveness vis-a-vis its main trading partners; combating climate change and improving resource efficiency; and concentrating effort on energy security, which also includes the expansion of renewables.

There is already considerable expenditure through the EU budget in this area of sustainable growth. At the EU level, investment in trans-European networks is considered an important element in improving the competitiveness of the Union, through the closing of gaps in infrastructure networks which are often created by national frontiers. The promotion of energy efficiency and new energy sources and the acceleration of the implementation of key strategic projects in Europe are also important.

This area of structural reform is also one in which the European Union can play a significant role in leveraging private and other funding through the promise of relatively limited EU funding.

Finally '*inclusive growth'* is concerned with the creation of employment, the development of personal skills and the reduction in poverty within the EU. In this area the European Social Fund has been active since the creation of the European Economic Community in 1957 and accounts for around 10% of the total budget in the current multiannual financial framework.

Cohesion policy is aimed at accelerating economic growth in the less prosperous areas of the European Union as they catch up with the more prosperous parts. With this objective the cohesion funds can be considered as the principal investment fund for economic development in the Union financed largely centrally from the EU budget, but requiring national co-funding.

It should be clearly stated that the structural funds are investment funds and should have nothing to do with the redistribution of income within the European Union. If they were to be considered redistributive, on the theoretical basis for EU budget expenditure outlined above, they would not be appropriate for the budget.

Structural funds should be additional to domestic investment funds and not a substitute for domestic sources of finance. National co-financing is also intended to ensure that cohesion funding is a cost on the national budget and not simply a grant with no implications for domestic financing.

In the last two years pressure has been exerted to ensure that the structural funds are used in a way which is totally in line with the Union's structural reform programme-Europe 2020.

While these four areas are the key policies promoting economic growth in the Union, it could also be said that other policy areas also potentially support growth. Trade policy acting to create or maintain an open world trade environment would certainly be included in this group of policies. Foreign policy might also claim to be growth promoting through the development of relations with some of the key economic partners of the Union.

C. The shape of the current budget

Before considering how the EU budget might be reformed to better support economic growth in the Union, it is necessary to analyse the shape of the current budget. Figure 2 shows the breakdown of the EU budget for 2011 by category of expenditure.[8]

[8] It would make more sense to analyse the 2007-2013 multiannual financial framework but unfortunately this doesn't really allow a sufficiently fine breakdown of expenditure categories.

If we assume that the expenditure category ’rural development’ is essentially assistance to agriculture, the agricultural budget continues to absorb 40% of the total budget. Agriculture is included into a general section of the budget with the title of ‘natural resources’ although agriculture makes up almost the whole of the natural resources chapter. Environment policy, an imperative of EU policy, accounts directly for only 0.2% of the total budget; however elements of EU environment policy can be found throughout the EU budget in areas as diverse as rural development policy, research and competitiveness.

Cohesion accounts for 36% of budgetary expenditure, the vast bulk of which goes to the convergence objective of the cohesion policy. Foreign policy picks up just over 6% of the total budget with administration at just under 6%. Internal security (citizenship freedom security and justice), though being considered one of the most important areas for policy development, accounts for a mere 1% of the total budget.

The non-cohesion budget categories, which were identified above as being crucial for accelerating economic growth and which form the core of the Europe 2020 strategy, account directly for no more than 9.5% of the total budget, although the bulk of cohesion policy must be added as it can be considered as a policy for economic growth..

As was clearly demonstrated above, the fact that a policy area is considered of crucial importance to the European Union does not qualify it for financial assistance from the budget. Many of the most important policies are in fact regulatory policies with very little need of financial inputs apart from administration. At present this is also true of citizenship, freedom, security and justice, although dealing especially with migration flows in the future may require larger budgetary funds.

The dominance of agriculture and cohesion funds is however the established and frequently discussed criticism of the EU budget. Both have very strong lobby support in the European Union, not simply by agents but also by member state governments themselves. It is worth analysing both policy areas in the light of the criteria discussed above for EU budget financing.

i. Agriculture

There are two pillars to the Common Agricultural Policy. The first consists largely of direct income subsidies to farmers, the second, rural development, aims to support the development of the rural economy. The first pillar absorbs the vast bulk of the financing of the CAP. In 2010 the single farm (decoupled) payment accounted for €37 billion with non-decoupled farm payments amounting to around €6 billion. Market measures which had previously been the main forms of agricultural expenditure are now relatively insignificant.

Expenditure on rural development at around €14 billion is nevertheless around 10% of the total EU budget. A disaggregated analysis of overall rural development expenditure shows clearly that most of it goes to the farming sector in the form of
Figure 2: commitment appropriations in 2011 budget (source European Commission)

Expenditure estimates for EU policies (billion EUR)	Budget 2011	Change from 2010
Sustainable growth	**64.5**	**0.4 %**
Competitiveness, *including:*	**13.5**	**5.0 %**
Education and training	1.2	4.4 %
Research	8.6	14.1 %
Competitiveness and innovation	0.6	8.2 %
Transport and energy networks	1.5	-25.2 % (1)
Social policy agenda	0.2	-10.0 %
Cohesion, *including:*	**51.0**	**3.2 %**
Convergence	42.5	5.0 %
Regional competitiveness and employment	7.1	-6.8 % (2)
Territorial cooperation	1.3	5.6 %
Natural resources	**58.7**	**-1.4 %**
Environment	0.3	10.9 %
Agricultural expenditure and direct aid	42.9	-2.1 %
Rural development	14.4	0.5 %
Fisheries	0.9	0.0 %
Citizenship, freedom, security and justice	**1.8**	**8.0 %**
Freedom, security and justice, *including* fundamental rights and justice, security and liberties, migration flows	1.1	13.2 %
Citizenship, *including* culture, media, public health and consumer protection	0.7	0.3 % (3)
The EU as a global player	**8.8 (4)**	**7.5 %**
Pre-accession assistance	1.8	13.2 %
European neighbourhood	1.8	9.3 %
Development cooperation	2.6	7.2 %
Humanitarian aid	0.8	3.0 %
Democracy and human rights	0.2	1.7 %
Common foreign and security policy	0.3	16.3 %
Instrument for Stability	0.3	32.2 %
Administration	**8.2**	**3.2 %**
European Commission	3.3	-8.5 %
Other institutions	3.4	16.3 %
Total	**141.9**	**0.3 %**

(1) Excluding energy projects to aid economic recovery.
(2) Decrease due to reduction in allocations to the so-called 'phasing-in regions', which were eligible under Objective 1 between 2000 and 2006.
(3) Excluding the amounts allocated in 2010 from the Solidarity Fund.
(4) Including emergency aid reserve.

support for structural change, agri-environmental measures, early retirement schemes or help for young farmers. The amount not going to support agriculture as such is minimal.[9]

From the point of view of stimulating economic growth in the Union, it is fairly obvious that investing 40% of the EU's budget in a low productivity industry is unlikely to be very effective, unless there are enormous unused productivity reserves in the sector. The latter is almost certainly not true - there is little new land which can be brought into production, it is unlikely that large new supplies of labour will be attracted to the sector and although technology could bring improvements in productivity, these would be relatively small when related to the whole economy.

Nevertheless the CAP is a common policy of the European Union, its place in the Treaty has just been confirmed by all member states through the ratification of the Lisbon Treaty and the principal role of the EU budget is to finance EU policies. However simply being an EU policy, as emphasised above, is not sufficient for a significant EU budget allocation. Above all the criteria for EU funding outlined above and the question of whether the funding meets the objectives of the policy also need to be taken into account.

The objectives of the Common Agricultural Policy are set out in article 39 of the TFEU - they remain essentially unchanged since the Treaty of Rome in 1957. They are:

- to increase agricultural productivity
- to ensure a fair standard of living for the agricultural community
- to stabilise markets
- to assure the availability of supplies
- to ensure that food is supplied to consumers at reasonable prices

Of course it is possible to argue that these should not necessarily be the objectives of the CAP and many have done so on the basis that the objectives which existed in the 1950s are surely not the objectives that we should have in 2011. Indeed in its recent communication on the Common Agricultural Policy, the European Commission suggests that the objectives should be:[10]

- food security
- quality, value and diversity of food produced sustainably
- to maintain viable rural communities for which farming is an important source of employment

Nevertheless we should expect EU budget financing of agriculture to at least meet the objectives outlined in the Treaty.

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[9] European Commission, 3rd. financial report from the Commission on the European Agricultural Fund for Rural Development, Brussels, COM (2010) 497.

[10] European Commission, The CAP towards 2020; meeting the food, natural resources and territorial challenges of the future. COM (2010) 672 Brussels, November 2010.

The overwhelming body of analysis suggests however that these objectives are not sufficiently met by the current funding of the policy.

Obviously a*gricultural productivity* has risen over the period from 1957 to the present day, but it is unlikely that the CAP has had anything to do with this increase. The old style CAP which guaranteed high prices to farmers for their produce lead to considerable expansion of production and an oversupply of agricultural produce, but at the cost of important negative externalities in the form of loss of biodiversity and other damage to the environment. Both in the old CAP and in the reformed CAP there was little incentive for farmers to farm more efficiently. Much of the support has gone into raising costs in farming, both in rents and in other inputs to the industry.

The changes that have taken place in European farming over the last 50 years have been very substantial and this is reflected both in employment levels and in output. However as a contribution to GDP, agriculture has declined to below 2% of total GDP in the European Union (1.7% in 2009). A significant impact of agricultural subsidies both in the old and new system has been to encourage marginal farmers to stay in the industry and has therefore probably reduced the speed of consolidation in agriculture. This has had the effect of slowing the rise in productivity.

Ensuring a *fair standard of living for farmers*, whatever this really means, has also not been achieved through the Common Agricultural Policy, which has always favoured large producers over smaller farmers. The current CAP even supports businesses which are not active in farming but which own land and qualify for direct income subsidies. The CAP is therefore rewarding farm enterprises which basically do not need subsidy. If it is seen as a policy aimed at redistribution, it is clearly failing.

It is not really clear what is meant today by the *stabilisation of markets.* However this objective is served more by regulation than by budgetary allocations.

Assuring the *availability of supplies* comes close to the idea of food security advanced by the European Commission in its recent policy paper. The EU is clearly not in the same supply situation that it was thirty or more years ago when the problem was oversupply. Today security of supply is certainly to be taken seriously by policymakers, as the demand from emerging economies rises sharply, as world population continues to increase,as the risk of interruptions in world trade are probably increasing and as climate change affects production.

However again the question is whether the European budget is an appropriate instrument for ensuring food security. The payment of direct income subsidies to farmers, linked to the size of holdings, does little for security of supply. Indeed the subsidies, as mentioned above tend to keep small unproductive farmers in farming. As the world supply situation becomes tighter so prices will rise for agricultural produce and, as long as the cost of inputs does not rise as fast, this will be a significant incentive for European farmers to expand output and become more productive.

The CAP has certainly not lead to the *supply of food to consumers at reasonable prices;* if anything it has led to prices being well above world prices. With the change in the CAP after 2000, EU prices have tended to converge with world trade prices but the CAP does nothing to ensure the supply of food to consumers at reasonable prices.

Even if one were to consider the objectives as suggested in the recent communication from the European Commission, it is doubtful whether the budget allocation to agriculture really meets these objectives. Food security has already been dealt with. The quality, value and sustainability of food production can be dealt with through regulation as well as non-budgetary elements of the Common Agricultural Policy and above all through the market. Finally the rural development budget has very little to do with the viability of rural communities.

One of the main arguments for the Common Agricultural Policy has also been that it preserves the internal market in agricultural produce. The argument goes that if there was no central funding for farming, individual member states would differentially subsidise agriculture leading to a breakdown in the internal market. This is however a strange argument given that European funding for other sectors of the economy, which are part of the internal market is absent. The common agricultural market can just as easily be established through regulation as through massive EU subsidisation and prohibition of national subsidies.

Rural development, the second pillar of the Common Agricultural Policy, also fails in its justification for major budgetary funds in that it does not appear to address the objective of the policy but is simply another form of subsidy for agriculture. It is true that some of the budgetary elements of rural development policy are aimed at improving the structure of agriculture, but the policy totally neglects the key elements of rural development, where agriculture today is frequently relatively unimportant.

There are however elements in the Common Agricultural Policy which would seem to justify some budgetary intervention. Encouraging farmers to farm in such a way that their activities are compatible with nature protection and the maintenance of biodiversity could justify payments from a budget. The protection of certain valuable landscapes in the EU could fall into the same category. Hill farmers or those working in the high Alps should perhaps be rewarded for not leaving those areas, which without farming would return to dense forest. However here there is a question of whether these payments meet the subsidiarity principle which should be applied to the budget. This sort of payment could perhaps be rather a national or even regional payment. EU budget subsidy to persuade farmers to farm in a more environmentally friendly manner might however also be justified by suggesting that environmental improvement is a European public good, with distinct cross-border externalities.

In conclusion, and applying the criteria discussed earlier in this paper, there seems to be little justification for the current Common Agricultural Policy budget, both direct income subsidies and rural development. The allocation of around 40% of the total EU budget to these activities certainly is not an efficient way of supporting economic growth in the European Union.

However there is a strong case for a substantial transition period for the gradual reduction in support to small farmers, given the social problems which an abrupt ending of all subsidy might cause. This transition period would probably need to last at least a decade or longer. Some authors have suggested offering farmers an upfront, one time financial compensation package in return for giving up future claims for direct income subsidies.

ii. Cohesion policy

Cohesion is mentioned as an objective of the European Union even in the preamble to the Treaty on European Union. It takes a prominent place in the aims of the European Union in article 3 TEU:

'it (the Union) shall promote economic, social and territorial cohesion and solidarity among member states'.

The European Regional Development Fund (ERDF) and the Cohesion Fund (CF) are established under title XVIII of the Treaty on the Functioning of the European Union and the European Social Fund (ESF) under title XI.

With such strong Treaty backing, it should be expected that cohesion policy finds an important place in the European Union budget. Indeed it does, accounting for over a third of the total resources. However again the fact that cohesion policy is an important policy for the Union is a necessary but not sufficient argument for a budgetary allocation.

The structural funds and the cohesion fund are combined to reach three sorts of objectives

- Convergence: to reduce the range of income measured in GDP per head between the poorer and the richer regions of the European Union by assisting the poorer regions to develop fast. Taken together the structural funds and the cohesion fund allot around 80% of the available EU budget finance to this objective
- Regional competitiveness and employment: here the objective is to reduce regional disparities within countries which do not benefit from convergence funds. About 15% of total cohesion funding goes to this objective
- the European territorial cooperation objective is a very small part of the total funding-around 2 1/2%.

Cohesion policy represents one of the core functions of government which is to address the question of equity or fairness. In as far as support is being made available to poorer member states, cohesion funding passes the subsidiarity check. The Cohesion Fund, which only operates in countries which have less than 90% of the average EU GDP per head meets therefore the main criteria for allocating the EU budget.

The ERDF however provides development finance for regions rather than for countries and defines regions which qualify for assistance as those with less than 75% of average EU GDP per head. If these regions are located in the poorer member states of the Union, there is really no problem as the subsidiarity criterion does not apply. However there is a problem when backward regions exist in rather well-off member states. This is for instance the case in Germany where the new Länder in eastern Germany benefit under the convergence criterion even though Germany is one of the richer member states. The question can be raised whether assisting these regions is not the responsibility of the German budget rather than the EU budget.

This argument is even more appropriate for the second objective of cohesion policy, regional competitiveness and employment. Funds are made available under this objective for regional development in areas which do not qualify for the convergence objective. The regions which receive money from the second objective may be backward areas of rather advanced member states and therefore the same question arises of whether development in these regions should not be financed by the member state concerned rather than by the EU budget. Around €7 billion is earmarked for this objective in the 2011 budget, or roughly the same amount as spent on foreign policy including enlargement and neighbourhood policy.

The second objective of cohesion policy underlines another problem that has arisen - the use of EU budgetary funds as incentives to member states to agree to policies on which unanimity among the member states is required. A substantial part of the competitiveness objective is spent in regions which no longer qualify for the convergence objective but which are being ‘phased in’ to the second objective from the convergence objective. Part of the convergence objective money is spent on regions which are being ‘phased out’: these regions have GDP per capita below 75% of that of the EU-15 but above that of the EU-27. But there are also even more obscure ‘pork-barrel’ allocations. The outcome of the 2007-2013 multiannual financial framework negotiation allocated Bavaria €75 million from the competitiveness objective although this is one of the richest regions in the European Union.

The aim of cohesion policy according to article 174 TFEU is to ‘reduce disparities between the levels of development of the various regions and the backwardness of the least favoured regions’. This is unfortunately an obscure sentence but the aim is clearly the reduction of disparities in the level of development between regions in the EU. There has been an enormous amount of analysis attempting to establish whether disparities are being reduced and if so whether this reduction can be at least partly attributed to EU cohesion policy and the allocation of budgetary funds. There is still no clarity in the answer to this question but this is not surprising. The advantages of countries with large agglomerations of manufacturing and service industries and with efficient infrastructures mean that disadvantaged regions may well find it rather difficult to catch up.

Rather than measuring disparities, it is better to judge cohesion policy on the basis of whether it is accelerating the modernisation of the economic and social infrastructure of the disadvantaged regions in the European Union. The answer to this question is probably easier and is almost certainly positive. Indeed from the point of view of the promotion of economic growth the convergence objective of cohesion policy is extremely attractive. Article 2a of the general cohesion policy regulation defines the objective as follows:

‘the Convergence objective, which shall be aimed at speeding up the convergence of the least-developed Member States and regions by improving conditions for growth and employment through the increasing and improvement of the quality of investment

in physical and human capital, the development of innovation and of the knowledge society, adaptability to economic and social changes, the protection and improvement of the environment, and administrative efficiency. This objective shall constitute the priority of the Funds;

During the current multiannual financial framework period 2007-2013, there has been a major effort to ensure that cohesion policy funds are invested in a way which is convergent with the aims of the Lisbon structural reform agenda, which has now become the Europe 2020 programme. A substantial percentage of the funds must be used by the member states to promote structural reform leading to an acceleration of economic growth.

There has also been an attempt to link the cohesion funds more closely with structural reform policy and more recently with the monetary union. The Union now adopts general guidelines for the implementation of the structural funds and the cohesion fund while the member states prepare their own national strategic reference frameworks taking into consideration the community strategic guidelines. These national programmes should obviously be consistent with the national reform programmes under the Europe 2020 programme. The national reform programmes are considered together with the stability and convergence programmes under EMU.

Policy coordination mechanisms of this type can of course simply be alibis for no action, but given the dramatic situation in the Eurozone there is hope that the link between structural policy and macroeconomic policy can be tightened.

There is of course scope for improvement within the convergence objective of the cohesion funds. The administration of the funds can sometimes be inefficient and the necessary cooperation between the European Commission, the member state and the regions is often far from perfect. The evaluation of individual projects within cohesion policy has also demonstrated that some projects have been a waste of money. These relationships are particularly difficult in the new member states of the Union where institutional arrangements had to be created from scratch after 2004.

Cohesion policy also shares the same problem as the Common Agricultural Policy in that a whole family of officials, consultants, policy entrepreneurs, regional governments and other beneficiaries has grown up and lives off the policy. This not only makes the overheads of cohesion policy rather high but it also means that it is extremely difficult to change the course of policy because this will always leave a powerful group of beneficiaries as losers and these will lobby their national governments and perhaps the European Parliament to prevent the changes happening.

In spite of all the problems associated with the cohesion policy budgetary instruments, the following conclusions could be drawn:

- the convergence objective, representing over 80% of the total cohesion policy budget, meets most of the criteria outlined above for budgetary allocations, including the subsidiarity criterion
- programmes under the convergence objective are potentially ideal vehicles for accelerating structural change and for promoting economic growth in the less favoured regions of the Union

- the competitiveness and employment objective probably fails on the subsidiarity criterion and serious thought should be given to the continuation of this funding, unchanged, in the future
- the linkage of cohesion policy to the Europe 2020 structural reform programme and to the stability and convergence programmes within monetary union is very important and should be strengthened in the future

iii. Competitiveness

In 2011 'competitiveness' commitments amounted to just under 10% of the total budget. Two thirds of this finance was spent on the research budget. Far smaller allocations were made to education and training, transport and energy networks and innovation.

Policies financed under this heading are very much in line with the policies of Europe 2020 and are closely related to the stimulation of economic growth in the Union. Once again however this does not necessarily justify an allocation from the EU budget - much can be done through regulation, financing from national budgets or from the private sector.

Theoretically expenditure on research in the EU budget can be justified. By combining the efforts of research teams in the member states, the EU can achieve advantages of scale in research, which can be of benefit to all of the member states. It meets the criteria of public economics and fiscal federalism as well as subsidiarity.

However there are a variety of problems associated with increasing expenditure on research:

- The problem of low research expenditure in the EU is really a problem of the private sector which invests much less in relation to turnover than the private sectors of the EU's major competitors

- How does the EU decide on the priorities for research spending and how much should be made available for research?

- Should the EU create new centres of concentrated research effort or rely on the networking of existing centres in the member states?

- Most research spending will be made in the most advanced member states. How does the EU ensure that the results of the research also benefit the less developed member states of the Union - in other words how does the EU overcome the problem of veto players worried about juste retour?

A thorough evaluation of research spending from the European Union budget in the past would probably not suggest that there had been very much EU value-added. The research framework programmes were extremely heavy in bureaucracy and the requirement that multinational research teams were a necessary condition for a research grant meant that some valuable research went unfunded or more likely attracted national or private sector funds.

The budget on education and training finances a series of programmes under the title ‘lifelong learning’ which aims to promote the exchange of students and teachers between educational institutions in different member states. It also supports a number of institutions which have been created to promote educational development in European Union.

Education and training spending at the EU level meets many of the criteria necessary to justify an allocation from the EU budget. The exchange of students and teachers between member states could theoretically be arranged by the member states themselves out of their own budgets, but this would be inefficient and complex and almost certainly more costly than when organised at the EU level.

Expenditure on networking in transport and energy is at present a very small part of the competitiveness budget, but it should be pointed out that expenditure on transport and energy in the less developed member states is funded from cohesion policy instruments.

Overall the competitiveness heading in the EU budget includes important areas in any EU development strategy. However there is no consistent policy running through this chapter of the budget and one has the impression of being confronted with a large number of pilot projects and a considerable inflation in institutional creations, the value of which needs to be tested. In the research area there is almost certainly a significant problem of delivery which needs to be addressed.

iv. Citizenship, freedom, security and justice

Spending in this area is a minute part of the EU budget - around 1% of the total 2011 budget. Much of the money goes to the area of migration including the return of illegal immigrants where the EU makes small contributions to member state expenditure, as well as to the EU border fund which helps to finance the protection of the external border.

With the Schengen system in place and the elimination of borders between member states, expenditure on certain migration policy actions is justified at the EU level. However there has been a considerable reluctance on the part of the member states to make policy in the migration area. If the member states prefer this to be an area with low policy density, one of the key criteria for EU budget allocation is not met.

Support for the cost of managing the external borders of the Union is an area where EU funding is eminently justified.

However with potentially large flows of migrants across the Mediterranean following the democratic revolutions in North Africa and various disasters in Sub-Saharan Africa, it is probable that budget commitments in this area of policy will rise.

v. Foreign policy

Foreign policy, including relations with countries acceding to the EU and neighbouring countries, absorbs only around 6% of the EU budget. As a common EU policy, which brings considerable political and economic benefit to all member states, one would expect the policy to be financed from the EU budget rather than from member state budgets. However the EU's Common Foreign and Security Policy sits uncomfortably together with the foreign policies of the member states.

Some foreign policy expenditure can be planned over the medium term. This applies in the case of the EU to spending on enlargement policy and European neighbourhood policy. However foreign policy has a habit of demanding rapid responses to sudden global emergencies and such emergencies are difficult to fund from the EU budget, which has relatively little flexibility.

The bulk of the development financing of the EU is of course financed off-budget through the European Development Fund, which amounts to over €22 billion for the period 2008-2013. It would be preferable if the EDF was properly budgetized in the EU budget, as this would give the European Parliament a more direct control and would be more transparent for European citizens. However opposition from key member states and from recipient states will ensure that budgetisation does not happen.

vi. Administration

The final part of the budget, administration, amounts to just under 6% of the total 2011 budget. While it is obvious that the administrative budget needs to be carefully controlled, including that of the European Parliament, it is obvious that a successful European Union needs highly qualified staff as well as a substantial budget for information and the promotion of European integration to its citizens.

In this paper only the expenditure side of the budget is dealt with. This is mainly because it is the expenditure side of the budget which determines the overall size of the budget. The revenue for the EU budget is automatically called in once the expenditure has been decided. There is however a very important debate about the composition of the revenue, which is not an 'own resource' in the sense which is expressed in the Treaty. The system of budget rebates given primarily to the United Kingdom but also to other member states is also contested (although technically the rebate is calculated on the expenditure side of the budget). However as the European Union budget has to balance on an annual basis, with no deficits or surpluses permitted, the revenue side of the budget can be ignored in a discussion of the use of the budget to support economic growth.

D. A budget aimed at economic growth

The aim of this chapter is to outline an EU budget which would meet the criteria outlined in the first part of this paper and which would be geared to sustaining economic growth in the European Union.

The growing awareness that it is difficult to run a monetary union in the absence of a political union may obviously lead, sooner or later, to a considerably larger European Union budget, capable of dealing with asymmetric shocks within the Union. This eventuality is not however considered in this paper. It would require a different sort of European Union and a different sort of budget with a degree of built-in stabilisation.

It is unrealistic to consider that an ideal budget for the Union would be totally aimed at accelerating economic growth. Other policy priorities need to be financed and indeed some of them may tend to restrict growth rather than foster it. However even in these non-economic policy areas it is important that projects and programmes are designed with the aim of supporting economic growth, even if this is not the primary objective.

This chapter is divided into two parts: general considerations and a draft EU economic growth budget.

1. *General considerations*

i. A budget which meets the criteria for EU funding

An EU budget to support economic growth should meet the public good and fiscal federalism criteria as well as meeting the subsidiarity and proportionality principles. However none of these criteria are absolutely clearly defined and in some cases budgetary funds which support growth may be acceptable at a cost of being somewhat less clearly justified on the basis of public policy or fiscal federalism.

The CAP budget however meets very few of the established criteria for EU budget funding and in a budget aiming at supporting economic growth only certain parts of that budget could be retained. Direct income subsidies to farmers would be extremely difficult to support. If these subsidies have the objective of increasing productivity in European agriculture and contributing to economic growth, this objective is being totally missed and direct income subsidies are the wrong incentive. If on the other hand they are part of the equity role of government, supporting small and relatively poor farmers, they are also missing their objective. Small farmers receive only very small subsidies from the CAP, which are now linked to the size of holding. By far the larger part of the direct income subsidy goes to large farmers or even to landowners who have no direct interest in farming and who certainly do not need the subsidy.

If the aim is food security, which is certainly an important objective in this rapidly changing world, it is difficult to see that direct income subsidies are going to contribute to this aim. This aim would be better served by encouraging small farmers to leave the industry and enable larger (and often younger) farmers to expand their holdings and increase output.

There is no doubt that agriculture performs vitally important work as well as producing food. The preservation of landscape, the maintenance of essential biodiversity, contributions to fighting climate change and support for social structures in the countryside are all important services which can be rewarded by society. But then this is better done at the national or regional level given the extreme diversity of agricultural structures, landscape, biodiversity and so on.

Given the rather long lags between investments and outputs on the farm, a major reduction in the size of the direct income subsidy budget would have to be introduced gradually over a series of years. But in the medium term the subsidies could be reduced to a relatively low level, releasing funds for other objectives in the EU budget.

ii. Delivery mechanisms and evaluation in the EU budget

Experience with the operation of the EU budget over several years suggests that efficiency of the delivery mechanisms for EU budget assistance has been inadequate.

For increased efficiency it is almost certain that responsibility for delivery must be further decentralised to member states, regions, agencies, and non-government bodies, including the private sector. Centralised control and delivery has been one of the major problems of the research budget, which has been noticeably inefficient.

To some extent the fault for this lies with the member states which are so worried about their net contributions and net benefits that they prefer for budget allocations to be made and delivered by the European Commission, which is seen to be neutral, rather than by other agencies which they may suspect of showing national bias.

It is obvious that EU budget allocations must be made in such a way that (goods and) services produced by those allocations are transparent and open to the whole of the Union. But in future more attention should be paid to efficiency and less to national balance and national pride..

It is also important to learn lessons from experience with EU budget allocations to ensure that resources are used efficiently to implement the EU policy to which they are linked. This requires more ex-post evaluation of actions then takes place currently.

iii. Flexibility in the EU budget

Flexibility is not a characteristic associated with the multiannual financial framework nor, less importantly, with the annual budget. Increasing flexibility is becoming ever more important as the world changes more rapidly. Events occur calling for a financial response, but the procedures for transferring money within the budget from one policy to another are rather heavy and indeed the transfer may prove to be impossible. Flexibility mechanisms already exist in the MFF and six changes were made to the 2007-2013 MFF between 2007 and mid-2010. However it would be desirable to have larger reserves and rather simpler possibilities for transfer from one policy area to another.

Additional flexibility will be important for the effectiveness of the budget although it may not be directly growth supporting.

iv. The EU budget and leverage

The EU budget is too small to have a significant impact on overall economic growth in the Union. The limited size of the budget may also be a contributory cause of a relative inefficiency in outcomes. It is still not general practice that ex-post evaluation is carried out and related to the ex-ante programme or project documentation. And of course on a larger scale member states use the budget to finance side payments to persuade other member states not to block key policy decisions. These inefficiencies are sometimes more common in small budgets than in larger budgets, where procedures are more formalised.

However even the current small EU budget could have a much greater impact on economic growth than it does today if it were used to leverage additional finance from member states and the private sector.

In the past, EU budget financing has usually been undertaken as simple grant finance or grant finance with some conditions attached. Direct income subsidies in agriculture are paid as grants although farmers are subject to rather ineffective cross compliance requirements. Budget support paid to countries in the neighbourhood under ENPI is essentially a grant to the budget of the receiving country, although it has to be incorporated into the national budget. Grants from the budget to educational establishments are usually in the form of simple grants with little conditionality.

Cohesion policy funds are also grants but they are at least combined with national budget finance. The resulting investment volume is therefore up to a third greater than the EU budget attribution. The additionality rule ensures that EU funds are not substituted for national funds.

Progress has been made in certain policies in introducing financial engineering and other techniques, which increase the total investment capital available in innovative ways. Most schemes have been set up together with the European Investment Bank which has a considerable experience in the use of financial engineering techniques.

Again cohesion policy is an area where various, admittedly small, financial engineering schemes exist. Four different schemes were introduced for the MFF 2007-2013 – Jaspers, Jeremie, Jessica and Jasmine. The Jeremie scheme works through national holding companies, which choose financial intermediaries to provide equity, loans or guarantees for private sector lenders to smaller enterprises. In this way risk to the private sector is reduced encouraging greater levels of private capital to be made available.

Guarantees are also used to promote the finance of Trans-European Networks. The objective is succinctly stated in the Commission communication:

'The goal of the guarantee instrument is to increase the leverage capacity of limited public resources to stimulate private sector investment in priority TEN-transport (TEN-T) projects by providing credit assistance.'

The aim is therefore to increase the private sector funds available to finance the extremely large infrastructure needs of the European Union over the medium and longer term. At present however the budget available is extremely limited.

Given the small size of the European Union budget, it is extremely important that these techniques should be used or at least tested in all policy areas where budgetary finance is made available. The European Commission has started work on a generalisation of financial engineering techniques across all policy areas and these should be written into the next multiannual financial framework.

Particular interest has been shown in the proposal that EU project bonds should be created in order to accelerate private investment in important infrastructure projects. The idea is similar to that used in the financing of the TENs. Loans or guarantees could be used to reduce the risk associated with private sector bonds issued to finance major infrastructure projects.

v. Structural reform and investment should be the 'fil rouge' which runs through the EU budget

Although the Europe 2020 programme has far too many 'priorities', overall it's agenda for structural change is a recipe for economic growth in the longer term, and it should therefore be one of the main criteria for EU budget actions across all policy areas. The Europe 2020 programme can of course only succeed if stable macroeconomic conditions are achieved. Stable macroeconomic policy however is linked in the Eurozone to success in stabilising the monetary union. As pointed out previously, apart from the European budget acting as a guarantor for balance of payments lending and the EFSM, macroeconomic and monetary policy do not appear in the EU budget outside the administration chapter.

Proposed budgetary expenditure, including that proposed by the European Parliament, should be subjected to a Europe 2020 test to ensure that it is contributing to longer term economic growth. Obviously in many of the non-economic policy areas, this may appear irrelevant, but these policy areas are relatively rare. Even in areas like support to education and training, structural change should be considered as a significant criterion for the selection of projects or programmes. Obviously it is only one out of several EU absolute policy priorities, which include social justice, peace and stability, and human rights including minority rights. But without economic growth many of these other priorities will be more difficult to achieve.

2. *An EU economic growth budget*

An ideal EU budget might consist of five chapters covering the main areas of policy, which require a budgetary input.

a. *An investment programme of structural change-cohesion policy*

This program will account for a very substantial part of the total EU budget. It would be split into two separate but coherent parts: a general investment programme of structural change highlighting the main objectives of the Europe 2020 project; and the cohesion funds aiming at the development of the low income regions and member states in the Union. These latter regions will also be eligible for funding from the general investment programme.

This programme would be derived from the priorities of the EU's structural reform programme. It could be organised under the headings of smart growth, sustainable growth and inclusive growth. However it might be preferable to manage the programme as an integrated development programme at the EU level, but with a high degree of disaggregation in the individual actions undertaken. The budget financing would be just one element of the overall development programme, a considerable part of which would consist of regulatory measures. The European Investment Bank would be very closely associated with this programme.

Smart growth is an ideal area for using the budget for its leverage value. Funds could be made available for projects in this area of structural reform on condition that matching funds could be raised nationally or from the private sector to ensure that the overall investment was considerably higher than the EU budget input. The budget could also be used for creating revolving funds in areas such as the financing of innovation (seed and venture capital), micro-credits and in some research and training areas.

This programme would have five priorities: promoting research across the EU, supporting the development of high-quality education and training, promoting innovation including the financing of innovation, investing in transport infrastructure and energy networking and developing the rural economy beyond agriculture.

In each of these areas it would be important to ensure that the criteria for EU budget funding are in general met. One element of the general rationale for such a programme, apart from the fact that the aims would be realising a major EU policy, would be the further development of the internal market of the Union and as far as possible the creation of European value-added through an increase in the scale of operations (notably in research), the pooling of experience across different member states and increased mobility across internal borders.

It would be essential to redesign the delivery mechanisms in the research, education and training and innovation areas. Management, apart from financial management, of this area of activity should be decentralised. This would include, in the research area, relying on expert committees consisting both of researchers and representatives of the business community, rather than civil servants and politicians to define the areas in which EU finance was being committed. It is rather important that decisions are taken rapidly and this can only be achieved by decentralised decision-making. One of the most important criticisms of the research programmes of the EU so far has been the delay in making decisions, as well as the bureaucracy and complexity of the procedures.

As far as possible the research programmes would be integrated into the whole EU research landscape and would link up groups of researchers in several member states.

In each of these areas a ceiling on the amount of budget funds to be committed would probably have to be decided ex-ante and the selection procedure would be competitive. In the area of the financing of innovation, the Union, and especially the European Investment Bank, already have a lot of experience in encouraging the provision of more seed and venture capital. As this is an area where the public sector works to leverage more private sector capital, the amount of EU budget finance required, netted out over the medium term, is likely to be very small and perhaps even negative!

Investment in the infrastructure network required to bring the EU up to the most advanced level in the medium and long term will be enormous. Most of this investment will be provided by member states and the private sector. The role of the budget must be to encourage investment in providing infrastructure linkages between the member states so that transport, energy, information technology hardware are properly networked across the whole of the Union.

Road, rail and energy networks exhibit many gaps which restrict the gains which would otherwise occur in the internal market.

Energy networks are particularly deficient in terms of linking up the whole of the Union and reducing the risk that a member state might be left short of energy as a result of political pressure from a third country or because of technical problems. The construction of missing links in the network may in some cases be an economically interesting enterprise for private sector companies. However in some areas this is not the case and there is a need for public sector intervention either as investment or as guarantees.

The contribution of the EU budget to such infrastructure development can only be a very small proportion of what is needed. And therefore again in this area intelligent use of EU budget resources to prise more investment out of the private sector would be important. The EU budget-backed scheme which already provides guarantees for the construction of trans-European networks should be expanded to accelerate the completion of the network.

Finally this programme would include rural development. It seems essential to remove the rural development programme, the second pillar of the Common Agricultural Policy, from the CAP and move it to an area which is far less closely connected with agriculture. The rural development programme could be revised to finance certain projects aimed at smoothing the transition from an agriculturally based economy to a more mixed and higher productivity economy and to favour environmentally sound development in rural areas. The justification for such a policy is probably weaker than that for the rest of this programme but it would serve the aim of accelerating economic growth and meeting environmental targets.

Cohesion policy should certainly remain a major part of any EU budget. This has been discussed thoroughly above.

However in the ideal budget aiming at economic growth, resources would be concentrated entirely on the least favoured regions or countries, while the competitiveness and employment objective of the structural funds would be folded into the new investment programme.

b. the climate change and environment programme

Tackling the problems which are associated with climate change is one of the key longer-term aims of the sustainable development agenda of the European Union. The EU, in contrast to most of the other major world trading blocks, has adopted relatively ambitious objectives:

- cutting greenhouse gases by at least 20% of 1990 levels (30% if other developed countries commit to comparable cuts)
- cutting energy consumption by 20% of projected 2020 levels - by improving energy efficiency
- increasing use of renewables (wind, solar, biomass, etc) to 20% of total energy production (currently ± 8.5%)

A climate change and environment programme would contribute to sustainable long-term economic growth in the Union. Without progress in these areas major longer-term costs will need to be met to tackle the problems which climate change will bring.

It is not immediately obvious that the EU budget will be called upon to finance or encourage the financing of the massive investment, which these objectives will need. Most of the effort will be required from the member states and from the private sector. The EU will of course be required to formulate the regulation which will be necessary to ensure that these objectives are met.

Relatively limited financial resources will be required for the research, which will be necessary to facilitate actions on the ground, and the EU budget may be called upon to finance pilot and demonstration projects in this area. The Union will also need to make sure that the aims of climate policy are taken into account in all other policies, and these other policies may be required to invest budgetary resources in their policy areas to meet these aims. This will be particularly important in cohesion policy and its structural funds.

It will be particularly difficult for some member states to meet the aims which the EU has set and there may be justification for envisaging a programme to help the states undertake the necessary structural change in energy sectors to achieve significant reductions in CO2. This concerns mainly the new member states but there would be justification in a separate programme to help these countries, as reducing emissions from these countries would facilitate key EU policy objectives.

Environment policy is of course far wider than the climate change agenda. Improving the quality of the environment and making medium and longer term growth environmentally sustainable are also important policies of the Union. At present calls on the EU budget from core environment policy have been relatively limited.

The agri-environmental schemes, which exist today under the Common Agricultural Policy, could be maintained and even expanded. While the evaluation of these schemes has been very mixed, they have contributed, at least in some of the more environmentally conscious member states, to increase biodiversity and attractiveness of the landscape.

Finally the European Union's greatest contribution to the control of greenhouse gases and to energy efficiency might well be in financing effective schemes in poor countries through the development agenda of the Union.

c. migration and internal security

At present the migration and internal security share of the EU budget is, as shown above, extremely small. Yet future economic growth in the European Union will certainly be affected by the size and character of migration flows into the EU.

At the time of writing however migration has suddenly become an area of considerable activity following on from the 'Arab Spring' with thousands of migrants from North Africa taking the opportunity to look for a better life in the European Union.

Up to now the financing of migration and indeed migration policy has been essentially a matter for the member states. Those countries which have borne the brunt of migration of unskilled labour have talked about burden sharing in the Union, which implies a centralised policy of relocating migrants across the 27 member states in order to spread the burden. In the past similar attempts have been made to redistribute large numbers of asylum seekers.

The appetite of the member states to agree to an EU migration system appears very limited. However an EU scheme to share the burden would probably involve significant EU budgetary funds. The argument would be that managing migrations in a way which is fair to all member states would be in the interests of the EU as a whole. However different groups of migrants prefer to settle in certain member states rather than others. Migrants from Pakistan and certain parts of Africa appear to prefer the United Kingdom, those from Tunisia aim to go to France and many Moroccans land up in Belgium. EU budgetary funds might then be requested by these countries who could argue that in accepting the migrants they were carrying out what is essentially an EU responsibility and avoiding a system of forced redistribution of migrants.

The arguments which are being made for major EU funding today appear to forget that migration has a positive value as well. Once migrants are integrated into the labour market of the member states they have arrived in, they begin to earn and pay taxes. To reward a country for taking a large number of migrants, which in the end is going to mean faster growth and higher tax revenues, would seem bizarre.

The outlook however is that even if there is relatively little common ground between the member states on migration policy, somewhat larger amounts of the EU budget finance will be required by this developing policy.

Beyond migration, internal security also includes asylum policy, the protection of the external frontier, anti-terrorism and anti-crime measures and drugs policy. Some of these areas already attract financing from the EU budget and this will tend to rise over time.

It would be unwise to imagine that this area will become a major part of EU budget financing, unless the member states move more quickly towards EU policy on these issues. The 2010 Stockholm Programme rules out additional financing to implement the programme under the current multiannual financial framework and states clearly that the programme has no implications at present for future multiannual financial frameworks.

The area most likely to require EU funding is work in third countries to combat international crime, drug smuggling, migration rings and other issues which threaten the internal security of the European Union. This expenditure may well be budgetised through the foreign policy programme.

d. foreign policy including development policy

One of the aims of the Lisbon Treaty was to develop a true European Union foreign policy. The creation of the position of High Representative and of a new institution, the European External Action Service, are intended to underline this determination. Foreign policy and development policy can contribute in major ways to improving the environment for economic growth in the medium and longer term

It is too early to say whether these initiatives will bear fruit, given that the most powerful member states appear determined to maintain their own foreign policy administration and occasionally even to prevent the EU from taking action.

Nevertheless it would be extremely strange if the world's largest trade block was not to spend more on foreign policy as the world becomes a more complicated place.

Foreign policy is frequently having to react suddenly to events and new situations in the world. Today the EU is in a particularly unfavourable situation to respond quickly to such events. This leads to a loss of influence abroad when other countries like Russia or China or even the United States are able to respond to particular needs much more quickly. This would argue for the existence of greater reserves for foreign policy in the EU budget.

But even when policy can be planned in an orderly manner over many months, EU foreign policy frequently disappoints.

Neighbourhood policy is a good example of the under-financing of assistance to key countries on the edge of the Union. The total budget under the current multiannual financial framework for the European Neighbourhood Policy Instrument (ENPI) is around €12 billion over seven years. The total population of ENP countries is around 260 million.

It is obvious that even with €12 billion or €1.7 billion per year, if well invested to foster structural change, valuable projects can be achieved. Using budget support the money can also be used to finance policies which are of importance to the ENP countries. Nevertheless relatively little fundamental change can be achieved with this level of financing. With increased differentiation proposed in the ENP Review document, those countries which have negotiated advanced association agreements, including deep and comprehensive free trade agreements, with the European Union will request more substantial funding to enable them to implement the harmonisation of regulation agreed with the EU in these treaties.

A hotly debated policy issue is how far foreign policy should be determined by the objective of accelerating economic growth in the Union. This would appear to be a totally justified aim, as long as it stands alongside the other policy objectives of the Union, including human and minority rights, democracy and peace. As the Union does not possess some of the instruments for making foreign policy that conventional states have, it is likely that the demand on the EU budget will rise as EU foreign policy becomes part of foreign economic policy.

e. Administration and other organisational expenditure

The budget for administration certainly does not sound to be an economic growth supporting element. However it is worth pointing out that an efficient and effective administration is vital for implementing public policy.

One could of course improve on the efficiency of the current administrative establishment. This would no doubt lead to the elimination of certain EU institutions and agencies and would impose greater financial discipline on the European Parliament.

E. Realpolitik as a constraint on budget reform

The ideas outlined in the previous section for a budget, which makes economic growth into one of its main aims, are not particularly new having been raised many times by EU budget commentators in the past. Indeed many of the ideas developed in this paper are already included in the EU budget review published in October 2010.[11] The problem is therefore less the generation of the ideas themselves than how to get them accepted in practice in future multiannual financial frameworks and in the annual budget.

[11] European Commission, 'the EU Budget Review' COM(2010) 700, Brussels 19. 10. 2010.

Five questions of practical politics will be raised here:

- the problem of the 'Juste Retour' - net beneficiaries and net contributors. Top-down or bottom-up budgets.
- The EU budget as a cost on national budgets at a time of fiscal stringency
- The problem of interest groups and the budget
- The EU budget and the rise of Euro-scepticism in the member states and in member state governments
- The problems associated with path dependency in the budget

i. The 'Juste Retour' problem

The EU budget can be approached as a 'bottom-up' process or a 'top-down' problem. Logically the key policy elements which need financing would be selected, their financial requirements would then be estimated and the resultant budget would be the sum across all of the policy fields. However such a process rarely takes place without there being some idea of the overall size which the budget might have.

In the EU budget, the top-down constraint is even firmer than in most national budgets. This is basically because most member states look on the EU budget to maximise their benefits or to minimise their contributions. This problem of the 'juste retour' has plagued policy-making in the EU for at least the last 30 years. Policies are often judged not on their capacity to bring benefits to the whole EU, but on their impact on the balance of benefits and contributions that each member state will achieve if the policy is implemented.

In order to limit their overall financial exposure to the EU budget, net contributors attempt, usually successfully because of the unanimity rule, to establish a maximum level of expenditure for the multiannual financial framework as a percentage of EU GDP. Several member states have already announced that they do not want the MFF for the period beyond 2014 to exceed 1% of EU GDP.

On the other hand net beneficiaries attempt to ensure that the policy sources of their transfers from the European Union do not have their budgets reduced by demands from new policy initiatives.

Various proposals have been made to alleviate the juste retour problem but without any concrete results. As a result of pressure from the main net contributors a variety of compensation mechanisms have been introduced, starting with the British budget rebate, which have made the EU budget an extremely complex instrument. It would make the budget much easier to understand if all rebates were eliminated.

ii. The EU budget seen as a drain on member state budget resources

The finance ministries of most of the EU member states see national contributions to the EU budget as a cost on their own budgets. The main net contributors resent a situation of having to transfer resources to the European level, but even in net beneficiary countries the fact that the reverse flows of finance from the European

Union to the member state generally do not end up in the national budget means that for the finance minister the gross contribution to the EU budget is unwelcome.

At a time when most member states are going through a period of fiscal consolidation and budgetary retrenchment, it is obvious that contributions to the EU budget are going to be extremely unpopular.

iii. The problem of interest groups and the budget

As in all national budgets, powerful interest groups have grown up around the main elements of the EU budget. However at the EU level these interest groups may have more impact than they would in a national budget setting. Whereas in the national budget an interest group arguing for a larger allocation from the budget will face other groups in society who do not want to lose budget allocations, at the EU budget level this is less the case. Politicians in the national setting know that gaining votes by allocating funds to one group will probably lose votes from other groups. At the EU level member state politicians arguing for the maintenance, for instance, of agricultural subsidy do not face a backlash from other groups of voters in their member state, because rising agricultural subsidy does not imply lower allocations for other national groups. This means that interest groups around the main EU policies can bring enormous pressure to bear on their national politicians to defend their budget allocations in Brussels.

Given the fact that 80% of the EU budget is spent on agriculture and cohesion policy, it is in these two areas that interest groups are most active.

Although agriculture represents only around 2% of EU GDP and only a little more than that of the active population, its lobbying power is considerable. Demonstrations in Brussels are frequent and loud, but most effective lobbying is done in the national capitals. France has become the champion of maintaining the budgetary allocation to agriculture, partly because it is a clear budget beneficiary of agricultural policy, but also because its rather small farm population is nevertheless a potent electoral force. France is supported by other member states which still have a considerable agricultural sector to their economies.

Cohesion policy has a somewhat less potent interest group because it affects member states and regions rather than individuals in the way that agricultural policy does. There is naturally a strong group of countries which are net beneficiaries of cohesion policy and who will attempt to maintain the level of transfers, but cohesion policy has less impact on domestic politics than agricultural policy. There is however a large group of cohesion policy experts and consultants, who form a strong lobby for the continuation of this policy. Many of the members of this group are interestingly located in countries which are not major beneficiaries of the policy - the UK, France, Germany and the Nordic countries.

The existence of these strong interest groups and the need for unanimity in the Council, makes it extremely difficult to radically change the structure of the European budget.

iv. Euro-scepticism and the budget

The European Union is going through a particularly difficult period in its development. The most destructive element is the crisis in the Eurozone, which is leading to citizens of the stronger economies criticising the EU because they feel threatened by becoming permanent donors to the weaker peripheral Eurozone members. On the other hand citizens of those countries which have received financial support from the EU feel that they are having to suffer cuts in their living standards and higher unemployment because of the restrictive fiscal policies imposed by the EU.

The problems imposed by migration flows from North Africa which have led to a weakening of the free movement guarantees contained in the EU treaties are also negatively affecting the reputation of the EU with the citizens of some member states.

These and other problems which the EU is having to face are leading to a rise in Euroscepticism, not only in the traditionally Eurosceptic countries such as United Kingdom, but also in core Eurozone countries like Germany and the Netherlands. It is not only citizens in these countries who are becoming less supportive of European integration, it is also true of government as well. During the financial crisis the member states were forced to act quickly and independently. There was little sign of European solidarity or even respect for some of the competition and state aid rules of the Union. It is true that fortunately few steps were taken which really impacted negatively on the functioning of the internal market. Nevertheless the perceived absence of the European Union in the period of financial crisis encouraged politicians in government to take a more national rather than a Community approach to policy.

In these circumstances there is going to be little support, certainly amongst the net contributors, for a larger medium-term budget in the coming period or even for significant changes in the structure of the budget.

v. Path dependency and the budget

The cumulation of these elements of resistance to changes in the size and structure of the budget means that the scope for moving the budget in the direction of supporting economic growth is very limited.

With so many different veto players among the member states, the easiest way to achieve unanimity on a new MFF is to change as little as possible. There is therefore a strong path dependency in the European Union budget, which is only marginally disturbed by significant changes in the structure of the European Union such as the fifth enlargement in 2004. The EU budget has not changed fundamentally since the Treaty of Maastricht at the beginning of the 1990s, even though the world economy looks very different today than it did 20 years ago. Then as now the budget is dominated by agriculture and cohesion policy. It is true that new elements such as climate policy have been introduced but they remain very small parts of the overall budget.

This path dependency of the budget is not the result of resistance to change in the European Commission, which is responsible for the first draft of the MFF. It is due largely to the political deals done between the large member states of the Union.

From this discussion of the politics surrounding the EU budget, it is clear that the radical change with the aim of promoting economic growth proposed in section D above is in fact unrealistic. The resistance of the member states to such a change can only be broken down in the medium and longer term or through a radical change in the 'constitution' of the European Union. It is possible that such a constitutional change might happen through the challenge of the Eurozone crisis but this is unpredictable. The best one can hope for is that small changes are introduced into the next multiannual financial framework, which might have a positive impact in terms of economic growth and which may lead in the longer term future to a more rational EU budget.

F. What can realistically be achieved to reform the multi-annual financial framework after 2014?

Ideally, as argued above, direct income subsidies in agriculture and the competitiveness and employment objective of the structural funds should be (gradually) eliminated from the EU budget. To this can be added the British and other budget rebates, which have grown up over the last 30 years but which have not been discussed in this paper.

However key member states already moved to protect their budget positions long before the European Commission produced its first draft of the new multiannual financial framework in June 2011. This increases the likelihood that the next agreed MFF will be very similar to the last one, with no measurable gain in efficiency and doing little to support economic growth in the Union.

There has already been a loose agreement amongst the main net contributors that the next MFF should not exceed 1% of EU GDP. The French have moved to protect the Common Agricultural Policy and it is highly likely that the British have traded the protection of its budget rebate against non-aggression towards the CAP. Germany will be keen to protect cohesion policy funds to the new Länder in the east of the country all of which now, with the exception of Northeast Brandenburg, exceed 75% of the average EU GDP per head. Spain too will be keen to maintain assistance to its regions, which now also exceed the limit for convergence status. And even some of the cohesion fund countries support the maintenance of the competitiveness and employment objective in the structural funds because they fear that if some member states are not benefiting from the funds they will turn against even the convergence objective funding.

What might be achieved in the face of these overwhelming odds?

If the net contributors insist on a budget cap of 1% of GDP, then freeing up finance to invest in policies which will support economic growth essentially depends on reducing the finance going into agriculture and the structural funds as a percentage of EU GDP.

In the Common Agricultural Policy one way of reducing expenditure would be to cap direct income subsidies to non-agricultural land ownership and to larger and generally more prosperous agricultural holdings. Such a move would probably receive overwhelming support in the Union except from France Germany and the UK. It would also be a popular move amongst European taxpayers who fail to see why transfers from the CAP should be going to rich landowners, who have no need of state subsidies.

Such a move would of course underline the social nature of the Common Agricultural Policy, emphasising once again that direct income subsidies should be paid by member states rather than the EU budget. Nevertheless politically it would be advantageous to accept such a distortion of EU budget logic if the gain was a major reduction in CAP expenditure or at least CAP funds were being more creatively used.

Unfortunately the three main opponents of such a change are perhaps the three most powerful budget negotiators in the Council. Nevertheless there are very few arguments, which can be brought against such a move and public opinion even in these countries is unlikely to be in favour of subsidising the rich and the prosperous.

This move would free up EU budget funds but of course it would do little to encourage rationalisation in agriculture, which would require small and often old farmers to sell their land to larger and more dynamic farm ‘entrepreneurs’. This can only be achieved by tackling the whole question of whether direct income subsidies should be paid at all.

A gradual reduction over time of all direct income payments needs to be the aim, although it is not sure what can be achieved in the coming negotiation on the MFF given the resistance in the Council and in parts of the Parliament. Schemes which on paper look promising, such as offering farmers a one-off lump-sum payment in return for giving up claims to EU subsidy and therefore encouraging small farmers to take the payment and sell their land, are complex and unlikely to receive support from member states. However the arguments against direct income payments are rather strong. Food prices are rising not just in the shops but also at the farm gate; there is an urgent need to increase agricultural output which will require consolidation in agriculture which is being prevented by agricultural subsidy; direct income payments are distorting competition in agriculture because their level varies from one region to another; and most member states are urgently trying to reduce government expenditure.

The separation of the rural development budget from the agricultural budget would also be desirable from an economic growth perspective. Ideally the rural development programme should be integrated with the structural funds. This would allow real rural development to be undertaken rather than the current situation where this policy is simply another form of subsidy for agriculture.

Budget expenditure on the convergence objective of the structural funds and on the cohesion fund should be maintained. There should however be pressure to improve the management of these funds, to reinforce the need for convergence objective finance to support Europe 2020 policy and to improve evaluation of the projects undertaken.

An effort should be made at least to reduce the finance spent on cohesion policy outside the convergence objective. The important principle here is that transition out of the convergence objective should be more rapid and final than was the case in the current MFF. No further transitional arrangements should be agreed for the period after 2014. It is true that some of the actions undertaken under the competitiveness and employment objective have been growth enhancing but most of these actions could have been undertaken by national budgets. In general they were too dispersed to have any serious impact. If the idea was accepted of a budget programme 'Investment for structural change' as proposed above, some of these actions could automatically flow into this programme, where they would be part of an overall development programme.

Getting agreement on areas of new spending is likely to be less difficult than to get agreement on where to cut the budget.

It may be somewhat easier in the run-up to the next MFF to get agreement on somewhat higher spending on the priorities of the Europe 2020 programme, following on from the financial crisis and the recession of 2009-2010. This concerns research spending and spending on educational schemes. As mentioned earlier an increase in research spending should be made dependent on a review of the delivery mechanisms in the programme.

Energy networking has also become a priority given the supply crises of recent years and now the decision of the German government to close all nuclear plant. Arguments in favour of increased spending on Trans-European Networks may also receive general approval

All member states recognise the importance of climate change and environment policies but it seems unlikely at this stage that there will be major spending programmes at the European Union level, in spite of loud demands from non-government organisations. The level of popular demand for these policies has also decreased under the pressure of the financial squeeze which has affected most EU countries.

Increased spending on migration and internal security may be rather limited by the reticence of member states to agree on EU level policies in these areas.

Foreign policy should be an area where budget expenditure increases. Spending on the EU's immediate neighbourhood is likely to rise both in terms of supporting countries in the Western Balkans but also those in the European Neighbourhood Policy. Increased spending in the neighbourhood would bring economic as well as political advantage to the Union.

Developing policy towards the EU's major trading partners should also be a priority, but may not involve the use of large amounts of budgetary finance. Development assistance on the other hand is likely to rise as crises associated with climate change, food security and raw material prices become more dramatic.

Finally the European Union may well be called upon to make payments to third countries in areas such as climate change and internal security in order to realise its political objectives.

The European Commission's Proposal for the Financial Framework 2014-2020 (MFF 2014-2020).

While it is not the purpose of the current study to analyse the Commission's proposal for the coming multiannual financial framework, it is interesting briefly to see to what extent the proposal indicates the possibility of changes in the direction taken by the EU budget.

It should be remembered that the Commission's proposal for the current multiannual financial framework 2007-2013 introduced some significant changes in the budget but that the Council of Ministers essentially took over the proposal and changed it to a certain extent into a Council budget. The fact that the figures proposed by the Commission for the coming years are not dissimilar to those in the current MFF together with the fact that MFF 2014-2020 is rather modest in its overall volume suggests that the Commission this time round wanted to present a budget sufficiently close to what the Council wants that it, the Commission, could this time keep control of the negotiation process.

The Commission proposal suggests that over the coming seven years only slightly under three quarters of the total budget should go to agriculture and the structural funds (figure 3). The remaining areas of policy, some of them crucial to the future development of the Union would only receive relatively small amounts of budget finance.

There are however some significant changes proposed in the two major budgetary policies.

In agriculture the Commission does suggest capping subsidies in order to avoid the large agricultural enterprises creaming off the larger share. It also suggests that direct subsidy should only be paid to active farmers. A third major change is the proposal that the level of direct subsidies should be gradually evened up between the new member states and the old member states, to cure a serious competitive anomaly which exists today.

The Commission also proposes that the structural funds proper and the rural development and fisheries funds should be considered together under 'a common strategic framework to ensure greater coherence between the sources of funding and a much sharper focus on Europe 2020'.[12] Nevertheless the overall proposal on the structural funds suggests little change in the distribution of funds across the Union.

[12] European Commission, A Budget for Europe 2020-part 2: policy fiches, COM (2011) 500.

Figure 3: the European Commission's draft MFF 2014-2020

MULTIANNUAL FINANCIAL FRAMEWORK (EU-27)

(EUR million - 2011 prices)

COMMITMENT APPROPRIATIONS	2014	2015	2016	2017	2018	2019	2020	Total 2014-2020
1. Smart and Inclusive Growth	**64.696**	**66.580**	**68.133**	**69.956**	**71.596**	**73.768**	**76.179**	**490.908**
of which: Economic, social and territorial cohesion	50.468	51.543	52.542	53.609	54.798	55.955	57.105	376.020
2. Sustainable Growth: Natural Resources	**57.386**	**56.527**	**55.702**	**54.861**	**53.837**	**52.829**	**51.784**	**382.927**
of which: Market related expenditure and direct payments	42.244	41.623	41.029	40.420	39.618	38.831	38.060	281.825
3. Security and citizenship	**2.532**	**2.571**	**2.609**	**2.648**	**2.687**	**2.726**	**2.763**	**18.535**
4. Global Europe	**9.400**	**9.645**	**9.845**	**9.960**	**10.150**	**10.380**	**10.620**	**70.000**
5. Administration	**8.542**	**8.679**	**8.796**	**8.943**	**9.073**	**9.225**	**9.371**	**62.629**
of which: Administrative expenditure of the institutions	6.967	7.039	7.108	7.191	7.288	7.385	7.485	50.464
TOTAL COMMITMENT APPROPRIATIONS	**142.556**	**144.002**	**145.085**	**146.368**	**147.344**	**148.928**	**150.718**	**1.025.000**
as a percentage of GNI	1,08%	1,07%	1,06%	1,06%	1,05%	1,04%	1,03%	1,05%
TOTAL PAYMENT APPROPRIATIONS	**133.851**	**141.278**	**135.516**	**138.396**	**142.247**	**142.916**	**137.994**	**972.198**
as a percentage of GNI	1,01%	1,05%	0,99%	1,00%	1,01%	1,00%	0,94%	1,00%
OUTSIDE THE MFF								
Emergency Aid Reserve	350	350	350	350	350	350	350	2.450
European Globalisation Fund	429	429	429	429	429	429	429	3.000
Solidarity Fund	1.000	1.000	1.000	1.000	1.000	1.000	1.000	7.000
Flexibility instrument	500	500	500	500	500	500	500	3.500
Reserve for crises in the agricultural sector	500	500	500	500	500	500	500	3.500
ITER	886	624	299	291	261	232	114	2.707
GMES	834	834	834	834	834	834	834	5.841
EDF ACP	3.271	4.300	4.348	4.407	4.475	4.554	4.644	29.998
EDF OCT	46	46	46	46	46	46	46	321
Global Climate and Biodiversity Fund	p.m.	p.m.	p.m.	p.m.	p.m.	p.m.	p.m.	p.m.
TOTAL OUTSIDE THE MFF	**7.815**	**8.583**	**8.306**	**8.357**	**8.395**	**8.445**	**8.416**	**58.316**
TOTAL MFF + OUTSIDE MFF	**150.371**	**152.585**	**153.391**	**154.725**	**155.739**	**157.372**	**159.134**	**1.083.316**
as a percentage of GNI	1,13%	1,13%	1,12%	1,12%	1,11%	1,10%	1,09%	1,11%

Overall however the Commission's proposal only marginally moves the Union's budget in the direction of stimulating growth and it is to be anticipated that the Council’s reworking of this proposal will move the MFF 2014-2020 even closer to its predecessor. This emphasises the point that the EU Budget is there to finance common policies and is not primarily aimed at stimulating economic growth.

Conclusion

There have been a large number of studies which have suggested ways in which the EU budget could be reformed. The European Commission's EU budget review included many suggestions which would make the budget somewhat more supportive of economic growth in the Union.

The problem is not a problem of a lack of ideas but one of resistance to change amongst the EU member states, which all have veto power over the new MFF. So soon after the entry into force of the Lisbon Treaty, it is impossible to consider a solution which would eliminate this veto power. The only approach for those who would like the European Union budget to be more supportive of growth and more efficient in its outcomes, is to argue on the basis of objective reasoning and rely on support for change from the taxpaying public.

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