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ON THE CHARACTER OF THE EU AND ITS BUDGET; LOOK INTO THE FUTURE

PETER WOSTNER

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Editors of the EU-Consent EU-Budget Working Paper Series:
Kálmán Dezséri, Institute for World Economics of the Hungarian Academy of Sciences, Budapest
(Email: kdezseri@vki.hu),
Friedrich Heinemann, Centre for European Economic Research, Mannheim
(Email: heinemann@zew.de)
Philipp Mohl, Centre for European Economic Research, Mannheim
(Email: mohl@zew.de)

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On the character of the EU and its budget;

Look into the future

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Peter Wostner**

<u>Abstract:</u>

This paper aspires to find the reasons for the allegedly slow and inefficient decision-making in the EU and in doing so also tries to predict what the future challenges imply for the organisational structure of the EU. It argues that due to asymmetric challenges, consensus should remain a European asset and that increased heterogeneity of preferences due to rising EU membership is in fact not the major culprit of inefficient decision-making. Instead, the paper shows that at least in the medium term the combination of another two factors lie at the root of the problem: firstly, the blurred division of responsibilities and secondly, the budgetary procedure, which gives Member States the incentive to approve policies without (sufficient) value-added to the EU. The following paper offers a concrete proposal how the budgetary process could be improved in order to remedy the decision-making inefficiency problem.

<u>Keywords:</u> EU budget, EU decision-making, multi-level governance, public finance

<u>JEL classification</u>: H11, H77, H87

* First version of the paper, including the proposal on the budget reform, was prepared in October 2007 (refer to http://ssrn.com/abstract=1025384) and represented one of the background papers for the Mrak et al 2007 report from which this paper also greatly benefited.

** Works at the Government Office for Local Self-Government and Regional Policy (GOSP), Republic of Slovenia, Kotnikova 28, 1000 Ljubljana, Slovenia. Views expressed in the paper are exclusively those of the author and do not necessarily correspond to those of the GOSP. Comments and suggestions are very welcome and should be sent to peter.wostner@ gov.si;

INTRODUCTION WITH THEORETICAL CONTEXT

Has the enlarged European Union (EU hereafter) really lost its ability to function efficiently? What implications do twenty-seven or even more member states have for the EU's ability to make decision and how should these be made? How can one explain the widespread agreement on the archaic structure of the budget - a fundamental and controversial issue, over which the Member States were unable to make any notice-worthy progress in spite of almost two years of negotiations?

Prior to the big enlargement of 2004, which resulted in ten new Member States, a likely blockage of the EU's decision-making process constituted a matter of great concern. Such bleak expectations did not merely stem from politicians and practitioners, but also from research and academia, which used theory to back up their case. Both the rationalist and the constructivist approach to decision-making in Europe namely make the same prediction about the consequences of enlargement: due to the increase in the group size, decision-making in the EU would slow down. However, the causal mechanisms for this conclusion differ (Olson, 1965; Leuffen, 2006).

The rationalist approach stresses the importance of formal rules, bargaining power and preferences of the actors. It is very likely for the latter to become more heterogeneous, as a consequence of enlargement (e.g. Baldwin et al, 1997; König and Bräuninger, 2004; Zimmer et al, 2005). Since the growing heterogeneity of preferences would reduce the size of win-sets, an enlargement should contribute to policy stability (Tsebelis, 2002), increase the probability of gridlock and ultimately reduce the efficiency of decision-making in the EU. The same outcome in the rationalist tradition is also predicted by the arguments of increased "bargaining complexity" (e.g. Zimmer et al, 2005), transaction costs (e.g. Schimmelfennig and Sedelmeier, 2002) and coordination and free-riding problems (e.g. Olson, 1965; Mueller, 2003).

The constructivists, on the other hand, understand preferences not as exogenously given, but rather as a result of social interaction, thus putting more focus on informal rules, norms, trust, common frames of reference and personal relations (e.g. Lewis, 2003; Heisenberg, 2005). Obviously, the norms, frames of reference, etc. are expected to reasonably differ among the old and new Member States due to different historical and cultural backgrounds as well as traditions, socialisation patterns, which should ultimately increase the level of conflict and make finding a consensus in larger groups more difficult. Contrary to rationalist logic, constructivists can account for medium-term convergence of social norms and thus also for a gradual improvement in decision-making efficiency.

These pessimistic predictions are hard to verify empirically, since the efficiency of decision-making in the EU should not primarily be measured on the basis of output quantity nor on the time-efficiency of the decision-making process. Instead, the primary focus should be on the quality of decision-making, which, of course, is notoriously hard to measure. It is for this reason that the growing body of literature accepts the second-best solution and makes conclusions on the basis of non-quality based indicators. One of the exceptions is the approach by Baldwin and Widgren, 2007, who use the so-called "revealed preference" reasoning to substantiate their argument on the necessity to reform the decision-making process in the EU. According to the authors, the EU leaders have access to the private information on the necessity of the decision-making reform, which can be derived objectively by looking at the decisions that have been made in the past.

This paper argues that the approaches mentioned above, which usually make use of "before-after" quantitative research designs, are susceptible to overlooking the potentially crucial qualitative factors in the decision-making process, which have a significant impact on its efficiency. This is not to say that the enlargement has had no impact on the efficiency of the decision making, but that this is not the crucial variable which influences the quality of the decision-making in the EU.

The paper is structured as follows. First, I will look into the types of challenges the EU is faced with and analyse to what extent they are asymmetric to different parts of the EU. The asymmetric shocks and challenges would have different consequences for the development and consequently for the optimal decision-making structure of the EU than in the case of symmetric ones. Asymmetric challenges result in a greater sensitivity of different parts of the EU to particular policies that might be decided on the EU level. In the subsequent section I will analyse the qualitative sources of the problems that the EU's decision-making is presently faced with and will suggest that in the context of asymmetric challenges, consensual or predominantly consensual decision-making is in fact an asset rather than a liability. On the basis of this, the following two sections make recommendations about how the decision-making could be improved: in particular with regard to the division of responsibilities as well as the budgetary procedure. The reformed budgetary procedure is of particular importance, not just in terms of its symbolic value as to what the EU is all about, but it is also at the heart of inefficient decision-making at least for those policies with financial consequences, i.e. the majority of them. It will be shown that the reformed budgetary procedure that is introduced would give the right incentives to the Member States to adopt the needed policies for the EU, which in turn would also permit a more beneficial division of responsibilities and would improve the efficiency of decision-making in general.

ASYMMETRIC CHALLENGES: INTERDEPENDENCE IN INEQUALITY

From an economic point of view the EU's main value added is represented by the Single European Market, which should, on the basis of free movement of goods, services, capital and people, ensure strengthened competition, enable the realisation of economies of scale and thus ultimately contribute to the welfare of EU citizens. Despite a major step forward in the abolishment of inter-state barriers, data show that national borders still decisively determine the »geography« of mobility and business operations in Europe (Dekker et al, 2006). For example, the effect that national borders have on the propensity of people to move between two places reflects itself in an implicitly increased time distance of two hours, and in the case of impact of distance on economic growth, national borders represents a time-distance of 600 minutes (Cheshire and Magrini, 2006a, 2006b). Even if common market was fully operational, however, the location and initial conditions of particular areas of the EU would still matter, not least due to the proximity to economic mass effect (Rice, Venables and Patacchini, 2006). Thus, the location of a particular subject within the EU is all but irrelevant and will continue to be so even if / when the common market is fully operational.

Last decade has also seen the introduction of the European Monetary Union (EMU hereafter), which contributed to the transparency of market operations and thus intensified the competitive pressure in the entire Union. The increased transparency will contribute towards restructuring the traditional patterns of business operations and creating new added value on the EU level. However, at the same time EMU can, on the basis of rigid production factor markets, also result in increased unemployment in case of asymmetric shocks due to the absence of an adaptable exchange rate. Labour mobility is particularly important in this regard because in economic areas with a higher level of labour mobility such as the United States, the unemployment rate rapidly returns to equilibrium after an internal or external asymmetric shock. However, the labour market characteristics of the EU and in particular its low mobility lead to unemployed people leaving the labour market, which results not only in lower unemployment but also lower employment rates of the affected areas (Braunerhjelm et al, 2000).

Globalisation represents the third asymmetric challenge to the Member States of the EU: the rise of new, rapidly growing economies in China, India and the entire south-east Asia to Latin America with Brazil in the lead. These countries compete less and less on the basis of relative labour abundance, but instead enter the markets with higher added value on the basis of a larger input of knowledge. In the long run the rise of these economies presents an opportunity for the EU as their growth - due to the market creation effect - positively contributes to the growth of the EU. On the other hand, the EU also faces the import substitution effect, with a number of EU countries also fearing the so-called relocation of jobs to countries with a lower cost of labour. Given the ever diminishing costs of trade, the pressure of competition in the EU will inevitably intensify, calling for an adequate response from the EU.

The common denominator of all these processes is that in future the EU will still be faced with extensive restructuring processes, which - assuming a positive scenario of strengthened comparative advantages - will result in a higher growth on the EU level. These advantages and benefits, however, in no way accrue automatically or evenly to all parts or areas within the EU. Apart from adaptability and specialization an increasingly important role in economic efficiency is played by the agglomeration economies or (localised) externalities, economies of scale, learning curve and path dependence, all increasing relative possibilities of the stronger and more developed areas that can gradually strengthen the tendency towards concentration of economic activity. At the same time it is also true that there are forces favouring deconcentration as the effect of congestion caused by the immobility of production factors or “love-for-variety” effect; the question remains, however, to what point these effects prevail. There is no consensus on the balance of these forces, however, empirical studies point out that the factors contributing to concentration, play at least an important if not a predominant role (e.g. Glaeser et al, 1992; Henderson et al, 1995; Paci and Usai, 1999; Ciccone, 2002; Rosenthal and Strange, 2003, Greunz, 2004; Cheshire and Magrini, 2006b; Bonaccorsi and Daraio, 2007; de Groot at al, 2008 to name but a few).

Thus, the EU is faced with profound asymmetric challenges calling for its dynamization if it wants to preserve competitiveness and economic activity on European soil. To meet these goals joint actions exploiting economies of scale on the EU level are badly needed, which additionally substantiate the existence of the EU and its policies (e.g. R&D policy). In meeting these challenges it is all but self-evident however, that the advantages resulting from the aggregate growth will be evenly distributed to different areas/regions, which renders necessary a balanced policy-mix that ensures a just distribution of benefits and costs among the Member States and the regions.

REASONS FOR THE EU'S DECISION-MAKING "INEFFICIENCY"

The presented circumstances indicate that European countries need the Union; at the same time it is obvious, however, that despite having common goals Member States have and will have rather divergent views on a number of policy dilemmas due to geographically asymmetric consequences of particular policies. This would be a matter of smaller significance if the EU had a higher labour mobility, because mobility would balance out the benefits and costs for an individual. Furthermore, due to historical and cultural differences and traditions, the citizens primarily consider themselves "citizens of the Member States" and will, at least in the medium term, continue to feel rather limited attachment to the EU. We should thus accept that due to the way we do business and especially because of the citizens' differentiated preferences and perceptions, the EU at least for now does not operate as a unitary system and also will not operate as such in the near future (Dekker et al 2006). This makes it difficult to imagine the EU as » the United States of Europe«, regardless of Schumann's vision from the 1950, on the foundation of a federal Europe and of an »ever closer union among the peoples of Europe«. Because of asymmetric results of particular policies for different areas, federalisation would lower the relative influence of each area on decision-making, meaning that federal organisation would very likely lead to serious internal conflicts. In the context of inter-governmental co-operation it is therefore the consensus that represents the central tenet of how the EU operates; this should be considered as a positive feature as it ensures cohesiveness of an otherwise increasingly heterogeneous union. It is the consistency of the policy-mix that makes general agreement and a functioning Union possible: enabling the introduction of policies that contribute to common public goods (security, human rights, foreign policy...), intensive development policies (Lisbon) and policies that ensure a harmonious development and equal possibilities (cohesion). Of course, the enlargement might have an impact on the exact balance of policies, but it is through the additional benefits brought in by the enlarged market, growth, know-how, etc., that justify the change of the previous balance. Thus, despite the strong critiques, balanced and consensual policies represent an asset and a European value which makes the EU stronger, not weaker.

A problem arises, however, if the necessary decision-making does not proceed fast enough to respond to the upcoming challenges or if some of the necessary decisions are not taken at all. As far as the latter is concerned it is very hard to theoretically justify the concept of "necessary decisions". If a certain democratically elected government under assumption of equally efficient and informed governments as well as undistorted incentives in the decision-making process rejects a certain policy then it simply cannot be justified as the right policy for the (whole) EU. With regard to the speed of decision-making however, it could be argued that, given the increasing global pressures, the EU should be reacting faster.

There seems to be a more or less general public consensus that Europe cannot function effectively with an increasing number of Member States. Baldwin and Widgren, 2007, argue for example that "there is no reason to believe, nor has there ever been, that the EU could enlarge from 12 to 27 members without streamlining its decision-making procedures". Recent empirical research, however, does in fact cast doubt on such a proposition. First, there are reports by the European Commission, which claim that "institutions have continued to function and to take decisions" (European Commission 2006: 19). More quantitative assessments can be found in Dehousse et al, 2006, who state that not only has decision-making not been blocked, but that in certain respects it was even expedited. In a similar vein Settembri reports that "after enlargement, the system delivers a comparable amount of acts; on average, it does so faster and without greater political contestation than before." (Settembri, 2007: 31). In terms of output quantity, Hagermann and De Clerck-Sachsse, 2007, also report that "the period immediately following the enlargement saw a general drop in the amount of legislation passed, but the annual adoption rate had almost 'recovered' by year-end 2006" and also that "the level of disagreement recorded officially in voting has not increased since the enlargement" (Hagermann and De Clerck-Sachsse, 2007: i). The "business as usual" conclusion seems to apply to the Council, the European Commission as well as to the European Parliament (Dehousse et al, 2006). It would be misleading, however, to conclude that nothing has changed. Settembri finds that although the overall number of bills passed has decreased only marginally the EU increasingly decides on marginal issues and that the decision-making process has become more bureaucratised (Settembri, 2007: 33). Hagermann and De Clerck-Sachsse, 2007, "explain" a significant part of the recovery with a much more extensive use of qualified majority voting. Furthermore, in the increasingly applied co-decision procedures between the Council and the Parliament, the decision-making after enlargement is some 22% slower than with EU15 (Settembri, 2007).

Thus, the enlargement has clearly changed the balance of policies and to a certain extent also the way the EU does business. However, it can hardly be argued that the EU needs to go in the direction of a greater "federalisation" due to an increased number of Member States and its resulting inability to decide fast enough. In fact Galub, 2007, has shown that, historically speaking, enlargements have increased the decision-making speed and the same is true for the qualified majority voting. The latter has already covered 53% of the legislation in 2006 (Hagermann and De Clerck-Sachsse, 2007), which means that the power of consensual approach within the framework of the EU was already weakened to a great extent. This has not only provided a benefit for faster decision-making but also for an increase in the power of »larger Member States« (Kauppi and Widgren, 2006). While such a trend can be justified to a certain extent, the EU should take care not to neglect the importance of a consensus in the Union since, as previously argued, the EU needs to preserve the general balance and proper consensus on the policy mix taken.

Instead of moving away from consensual decision-making, the problem of inefficient decision-making, as exemplified for example by the 2007-2013 financial perspective negotiations, should not primarily be explained by the rising EU membership. I argue that the inability for certain EU reforms stem from the perverse incentives that Member States are faced with in the decision-making process. They actually promote the inefficient »quid-pro-quo« attitude that encourages the Member States to follow their own partial interests. Secondly, the aforementioned "horse-trading" is additionally stimulated within the framework of a blurred division of competences among the EU and Member States . Thus, source of the EU's "inefficiency" problem in decision-making and consequently also in its modernization should be sought for in the area of institutional and organizational EU reforms. The approach should include: (1) a clearer vertical division of competences based on the logic of public goods and on the principles of fiscal federalism, and (2) on a simultaneous reform of the budgetary procedures, which should ensure a "balanced and justified financial burden" for all Member States, thus providing the incentives for proper policy decisions.

DIVISION OF RESPONSIBILITIES

A more thorough analysis of the division of competences in the EU goes beyond the scope of this paper. In principle it does appear, however, that the EU and especially the European Commission consume a lot of time and energy on issues outside (or at least not directly linked to) their jurisdiction. Instead, it would be more advisable to focus their attention - in terms of both human resources and in a political sense - on issues that were or should be transferred on a EU level. The European Commission is trying to expand the area of its operations, thus implicitly stimulating expectations by the »voters«, who rightly expect an improvement in a certain area in accordance with the given commitments. In dealing with these issues the chickens are often counted before they are hatched, because the instruments of decision-making and competences are simply not in the hands of the Commission or other European institutions. This reduces the transparency of the decision-making structures for the citizen, thereby also rendering the whole democratic structure of the EU less efficient.

Said issues are quite numerous, e.g. in the field of labour market liberalization and other structural reforms or the EU starting to become involved in the sphere of culture, sports and the like. The so-called principle of the open method of coordination is also increasingly being employed at the EU level, i.e., pressures »from above« are created to increase the implementation probability of particular policies - particularly in cases where this is politically questionable or sensitive[1]. This is potentially quite a dangerous approach as it blurs

[1] The implicit assumption is that on the EU level long-term policies can be introduced, while single Member States on their own would not be able to make such decisions. This could be described as a »paternalist argument«, which has a rather fragile theoretical foundation. In practise though, there might be circumstances

the boundary-line on the division of competencies, making it less clear who bears responsibility for particular (in)action. Thus, despite the formal obligation defined in article 5 of the Treaty on the European Union, the subsidiarity principle, which states that given competences and duties are to be performed on a higher level only in cases where they cannot be carried out equally efficiently on a lower level, can simply be ignored. Decision-making closer in line with the wish of people or, more specifically, on a level where benefits and costs arise, result in more optimal decisions due to better information and better transparency. This approach also promotes innovation, while centralization often leads to »one-size-fits-all« solutions for everyone, again asymmetrically affecting different parts of Europe.

On the other hand, certain procedures within the framework of delegated competences are already unnecessarily complicated, resulting in the reduction of potentially positive effects for the EU. Thus, for example, the European Commission has rightly full authority over the field of competition policy for cartel agreements and mergers obstructing free competition on the Single European Market, while on the other hand the Commission still lacks full authority over the field of anti-dumping measures, where each final decision must be ratified by the Council of Ministers, thus only broadening the possibility of decision-making based on »uneconomic principles«. There are also numerous incidents – from the Community Patent system to the extreme issues such as defence - where the EU does not claim jurisdiction over activity fields despite being justified to do so.

Thus, as shown in the examples above, the EU is increasingly taking decisions on issues where, taking into account the theories of public goods and fiscal federalism, no EU involvement is justified. Furthermore, increasing the use of softer coordination mechanisms reduces the transparency of the decision-making process, which provides a good breeding ground for "horse-trading". In other words, there is less need for decision-making than one would assume at first glance. There are, on the other hand, issues which should indeed be dealt with on the EU level, but are not. The inability to decide in such circumstances is significantly conditioned by perverse incentives for the Member States.

DISTORTED (FINANCIAL) INCENTIVES

Since the majority of decisions have financial consequences, the EU cannot devise an efficient decision-making system without the incentive structure that would ensure approval of the policies on the basis of their merit and value added. This is unfortunately not the case in the EU where the primary objective of the budget negotiations as well as of the debate on a particular policy with financial consequences is in fact determined by the policies' impact on the net financial position of a country in question. Thus, in deciding whether to support a particular policy or not, the Member States do not weigh the pros and cons of the policy and its value added, instead they simply calculate whether the policy brings more money into the country in question than it will need to pay for.

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and / or policy areas, where open method of coordination could have some positive (but also negative) consequences.

Such an approach results in the emergence of policies which improve the net financial position of a single (group of) Member State(s) but offer no added value to the Union at large, i.e. their implementation through the EU results in an overall net loss for the Member States (as well as for the EU). This kind of logic implies an essentially bigger volume of the previously mentioned »quid-pro-quo« bargaining among the Member States, as they are all but forced to do it since every country needs to benefit at least from some policies. Eventually, this means that the policy-balance in the present decision-making context is not determined by the merit of the policies but by the Member States' net financial positions (Mrak and Rant, 2007), which makes negotiations much more complex and notoriously inefficient. In order to break away from such a perverse incentive structure the redistributive and allocative elements of the budget should be separated (Begg and Heinemann, 2006) - the question is how.

What has been proposed already?

One strand of possible solutions is to be found in the prospect of a renationalisation of EU policies that have clear national/ regional benefits or in strengthened decision-making power for institutions with overarching European interest, i.e. especially the Parliament or the Commission (e.g. Heinemann, 2005; Gros and Micossi, 2005). As far as the former proposal is concerned such a solution is clearly the first best for those policies, which should not be implemented at the EU level in the first place, while for the others, such a solution could entail an efficiency loss for the Union (e.g. due to lessened competition). The problem with the latter, however, is that it is only feasible in the long run, as those institutions themselves currently have an inherent bias towards national interests or an "a priore" bias towards strengthening the EU level. In principle, a more short term solution is constituted by proposals which focus on the incentive structure in the budgetary process and "juste retour" debate. There are, by now, already a number of related proposals circulating. Richter 2008, for example, proposes to make the contributions to the EU budget in proportion to the relative economic strength of the member states, while expenditures to a given member state would be a function of a size of its population. In this way a fairness principle in the EU budget would be complied and "juste retour" would be removed from the equation as well. At the same time, however, the introduction of new European policies would be made much more difficult due to rigidities introduced on the expenditure side of the budget. More flexibility is preserved in the works of De la Fuente and Domenech, 2001, Begg and Heinemann 2006, Heinemann 2007, Heineman et al 2008 and De la Fuente et al 2008, whose family makes this proposal as well. De la Fuente and Domenech, 2001, put forward an overall redistribution parameter, which reflects the »relative net per capita transfer from the EU expressed as a fraction of the real income differential with the EU average in a typical member state« (De la Fuente and Domenech, 2001: 6) and is subsequently used in the general correction mechanism. Their proposal can be summarised as follows (De la Fuente and Domenech, 2001: 13):

> *"First, an agreement should be reached on the level of expenditure that will be required to meet EU policy objectives, on the regular mechanisms for its financing and on the*

desired degree of redistribution. Given this agreement, indicative net balances should be computed for each of the member states on the basis of their per capita incomes and an agreed-upon redistribution coefficient. Second, budget allocations to specific expenditure programs should be made on the basis of the relevant policy objectives, without regard for their impact on country net balances. Finally, structural spending and, if necessary, compensatory payments or rebates should be set so as to obtain the desired redistributive outcome, given the distribution of other expenditure items. The procedure will probably work best if it is applied in an incremental way, i.e. as a tool for identifying the desired direction of change from the status quo."

In order to implement this proposal all EU expenditures would need to be allocated among member states for which they propose different allocation keys (GNP for overheads, location of EU institutions for operating expenses, production of relevant agricultural markets for allocation of export rebates and price support interventions, etc.)[2]. The proposal by De la Fuente and Domenech, 2001, provides an answer to the wrong incentive mechanism for the Member States in the budgetary negotiations, however, at the same time it is faced with three problems or disadvantages itself. Firstly, the proposed calculation of the redistribution coefficient and thus the necessary complete ex-ante allocation of expenditures per Member States is relatively complicated, while at the same the redistribution coefficient itself does not provide a simple enough intuitive logic for the political level. Secondly, the redistribution coefficient implies by definition income per capita and the foreseen "fair" distribution function as fixed and the only possible one, which reduces the sometimes necessary flexibility in the budgetary negotiations. While objectivity can surely be considered as a positive feature of the proposal, it can also reduce the chances of its application in practice. Finally, the proposal by De la Fuente and Domenech, requires the overall size of the budget to be determined in the beginning of the process, which by definition requires a "top-down" approach. That is to say, the best way to justify the size of the budget is on the basis of justifiable policies and their impacts, and not by the size of the budget per se. In practice such an approach would require a discussion on the policies already in the first step, which would to a certain extent eradicate the positive properties of the reformed budgetary procedure.

The proposal in this paper would improve the above mentioned approach by rendering it simpler as well as more flexible. It additionally makes use of the proposition by Begg 2005, Begg and Heinemann 2006, Heinemann 2007 and Heinemann et al 2008, namely that the redistributive and allocative elements of the budget should be separated on the basis of the horizontal cash transfers and splitting of the budget in two parts. By joining the two concepts and concretising the procedures and institutional responsibilities, this proposal should hopefully add up to a politically more feasible reform that could be considered for the Agenda 2014 debate.

[2] The 2008 preliminary draft version of De la Fuente et al already departs from this proposition as it separates the »overhead or general-intrerest EU expenditures (including external action and administration« (ibid., 7) and is hence closer in line with our proposal.

Budgetary reform: an improvement

Part A: European public goods budget

This proposal starts with Heinemann's proposition that expenditure that could be classified as a European public good should be treated separately. The rationale for such a proposition is that by definition, the benefits of these expenditures cannot be attributed to particular Member States, thereby rendering them completely incompatible with the notion of a net financial balance per Member State.

In the 2007-2013 financial perspective this part of the budget would broadly refer to the following issues or chapters:

- Globalisation Adjustment Fund from heading 1a "Competitiveness for growth and employment"
- 3a: Freedom, Security and Justice
- Solidarity Fund in the framework of heading 3b (Citizenship)
- 4: EU as a global player
- 5 Administration

For this part of the budget the necessary extent of resources would be determined separately, while financing would be provided on the basis of countries' share in the EU's GNI. These contributions would of course not be included in the calculation of net budgetary balances as this cannot be justified or interpreted in any meaningful way. For the Solidarity and Globalisation fund it is the rationale and the by definition unpredictable nature of their mission that makes them both inappropriate as well as impossible to be included in the ex-ante calculation of net budgetary positions.

Part B: Expenditures with localised benefits

This part of the reformed budgetary procedure would determine the other headings of the budget, which can be classified into two groups:

- Group 1 would refer to the current headings 1b (Cohesion for Growth and Employment) and 2 (Preservation and Management of Natural Resources), whose allocation per Member States already represents part of the financial perspective negotiations simply because they are awarded on the basis of national envelopes.

- Group 2 would refer to the current headings 1a (Competitiveness for Growth and Employment) and 3b (Citizenship apart from solidarity fund), which are predominantly disbursed on the basis of calls for projects, i.e. on the principle of excellence and other selection criteria, which means that allocation per Member State can only be determined ex-post.

Group 2 in particular needs additional clarification as, contrary to the European public goods expenditures, the benefits of these expenditures can be localised, which does not hold true for the public goods. The main feature and quality of this group of expenditures is the principle of competition, which directly enhances the impact of public expenditures and therefore also brings value added to the Union as a whole. Nevertheless, due to the asymmetric absorption capacity of different Member States and regions, it is not possible to ignore that the localisation of benefits will be a disincentive to less "able" Member States to support such policies, since they will be disadvantaged in terms of their net financial position (and direct economic benefits). These benefits should therefore be taken into account in determining the net financial burden of the EU budget that each Member States will bear.

Budgetary procedure

For part A of the budget, the European value added expenditures, there are no pressing reasons for modifications of the budgetary procedure, which means that also in institutional sense, the budget would be approved by the current practice. Thus, the European Commission would prepare the proposed size of the budget by heading, which would subsequently either be submitted to the Council or to the European Parliament (as foreseen in the reform Treaty) and then finalised in the interinstitutional agreement.

It is the budgetary procedure belonging to part B of the budget which is in need of significant overhaul. In the first step the net payers and net recipients decide the absolute amount of redistribution per Member State, thus determining the target (and final) net financial positions of the Member States (excluding, of course, part A of the budget). In determining the extent of redistribution the fairness principle should be taken into account, which basically means that the more developed Member States should contribute more to the EU budget (cohesion objective). Even though the development level of the Member State presents itself as an obvious objective criteria to use for determining the extent of redistribution, one must not necessarily strictly follow whatever function or indicator (GNIpc,...) best complies with the fairness principle as long as redistribution is budgetary neutral - in other words, as long as net financial transfers are equal to zero. Such departures from the objective criteria could potentially be justified on the basis of a catastrophic natural disaster of greater proportions with multi-annual financial consequences, which could justify smaller net contributions by the affected Member State. In any case, such flexibility, if used wisely, could greatly improve the political acceptability of the proposal, because it makes it very simple for the politicians to find a consensus.

As to the institutional procedure, the proposal on the extent of redistribution would be prepared by the European Commission and would be approved by the European Council after consultation with the European Parliament. According to the new Treaty, it would first be sent to the Parliament and only then to the Council. Because the EU budget is still predominantly financed from the Member States' contributions, it would appear more justifiable from a theoretical point of view, were the Council to continue playing a dominant role in this part of the budget preparation.

In the second step the European Commission would prepare the proposal on the scope and content of particular policies, which should in any case first be sent to the European Parliament and only then to the European Council, because at this stage, the net financial position of particular Member States had already been ensured. This invests the “contents” and the policies at the expense of the size of the budget with a relative priority, thereby justifying a greater direct involvement of European institutions. In terms of timing the optimal solution would be for the European Parliament to send both parts A and B of the budget to the Council simultaneously.

Apart from formulating the proposal on the EU policies, the European Commission would also need to prepare the “ex-ante allocation of expenditures” by Member State, which would allow the calculation of “spontaneous net financial balances” in part B of the budget. For the expenditures of Group 1 (cohesion, agriculture), this can already be derived directly from the policy proposals, while for the expenditures of Group 2 (competitiveness,...) the Commission should take into account the average absorption rate of the Member State from the previous financial perspective[3]. During the implementation of the financial perspective particular Member States can be more or less successful than actually assumed during the negotiation, however, this would not affect their contribution to the EU budget, which would in turn retain their incentive to be as active and successful in competing for this part of the resources, thus completely preserving the competition principle. On the other hand, making use of the absorption rate in the previous financial perspective would in the long run still represent at least some sort of “security net” for contributions of the “less competitive” sort, which would thus also be politically more acceptable.

Implementing the above decisions would make it possible, in the third step, to calculate the extent of contribution in the EU budget by Member State, which equals the ex-ante allocation of expenditures to particular Member State increased / reduced for the target net financial position (extent of redistribution) as agreed and approved in step one.

Table 1 presents a stylized example of the proposed system on the basis of two policies for three Member States’ Union: let’s assume that the Commission, Parliament and the Council would agree on two policies, with the ex-ante allocation per Member State as presented in the first two rows (step 2). In order to calculate the contributions (step 3), all that is needed is to subtract the agreed extent of transfers as decided in step one (presented for two cases reflecting different extent of redistribution: step 1 case 1 and 2) from the total allocation per Member State.

[3] For those Member States for which past performances are unavailable or are not comparable for any other reason (e.g. in case of enlargement), the Commission would calculate the expected allocation on the basis of simple regression equation explaining the allocation with variables auch as GDP pc, number of researchers, etc.

Table 1. Stylized example of the proposed budgetary system

Member State:	Recipient	Average	Developed	Total
Step 2: Policy X allocation per MS - € billion	20	30	50	100
Step 2: Policy Y allocation per MS - € billion	90	10	0	100
Step 2: (2) Total allocation per MS - € billion	110	40	50	**200**
Step 1 *CASE 1*: Net budgetary balance - € billion (1)	**+ 10**	**0**	**-10**	**0**
Step 3 *CASE 1*: Contribution by the MS to the EU budget - € billion = (2) - (1)	100	40	60	200
Step 1 *CASE 2*: Net budgetary balance - € billion (1)	**+ 30**	**0**	**-30**	**0**
Step 3 *CASE 2*: Contribution by the MS to the EU budget - € billion = (2) - (1)	80	40	80	200

As can be inferred from table 2, doubling the policy, in this case termed X, which yields greater relative localized benefits to the more “developed” member state, would not be blocked by the recipient country, since a predominant part of the financial burden of the policy (and budget as a whole) would be covered by the county which receives the greatest benefit from its increase.

Table 2. Modified example with strengthened policy in the interest of a “developed” country

Member State:	Recipient	Average	Developed	Total
Step 2: Policy X allocation per MS - € billion	**40**	**60**	**100**	**200**
Step 2: Policy Y allocation per MS - € billion	90	10	0	100
Step 2: (2) Total allocation per MS - € billion	130	70	100	**300**
Step 1 CASE 1: Net budgetary balance - € billion **(1)**	+ 10	0	-10	0
Step 3 CASE 1: Contribution by MS - € billion = **(2) - (1)**	**120**	**70**	**110**	**300**
Step 1 CASE 2: Net budgetary balance - € billion **(1)**	+ 30	0	-30	0
Step 3 CASE 2: Contribution by MS - € billion = **(2) - (1)**	**100**	**70**	**130**	**300**

On the other hand, the recipient country, should it not believe that redistributive policy Y has genuine European value added, would no longer have the incentive to defend such a policy as its net budgetary balance would be the same – irrespective of the size of the policy - see table 3. Hence, the expenditure side of the budget would be determined on the basis of particular policies' merit, while the budget as a whole would comply with the (politically acceptable) fairness principle.

Table 3. Modified example with a weakened "redistributive policy Y"

Member State:	**Recipient**	**Average**	**Developed**	**Total**
Step 2: Policy X allocation per MS - € billion	20	30	50	100
Step 2: Policy Y allocation per MS - € billion	**45**	**5**	**0**	**50**
Step 2: **(2)** Total allocation per MS - € billion	65	35	50	**150**
Step 1 CASE 1: Net budgetary balance - € billion **(1)**	**+ 10**	**0**	**-10**	**0**
Step 3 CASE 1: Contribution by MS - € billion = **(2) - (1)**	55	35	60	150
Step 1 CASE 2: Net budgetary balance - € billion **(1)**	**+ 30**	**0**	**-30**	**0**
Step 3 CASE 2: Contribution by MS - € billion = **(2) - (1)**	35	35	80	150

Value added and (political) feasibility of the proposal

The improved proposal provides a simple and flexible method for the Member States to agree on their net financial positions and thus pulls the "juste retour" out of the equations to the maximum extent possible. Simplicity and flexibility can be considered as an asset since it greatly improves the political acceptability of the proposal, i.e. if proposal is not based on a formula(s) and does not require the allocation of *all* expenditures by Member States. This makes it possible not just to put net financial position out of the spotlight but also the size of the budget and thus to put focus on the policies that the EU should pursue, which would significantly improve the quality (and consequently also efficiency) of EU decision making. This means that the size of the budget can be determined as a result of the agreement on policies (step 2) instead of vice versa, which means that the budget would in fact be prepared on predominantly bottom-up logic. The proposal furthermore includes an incentive mechanism that would preserve the competition principle also in part B of the budget, promoting a better use of the EU resources. Finally, the proposal removes those expenditures that represent a European public good (these are identified) from the net financial positions debate, which renders the budgetary procedure both simpler and more objective.

What these improvements come down to is that the proposed budgetary procedure provides a tool for a more significant reform of the budgetary structure in line with the asymmetric and symmetric challenges already posed in the medium term, i.e. for the Agenda 2014, without any detrimental effects on the solidarity principle and with a radically improved fairness principle in the EU finances. As shown by Mrak et at, 2007, the long term budgetary vision is dependent on the political vision of the EU, which in turn means that a fundamental reform of the budget could only be realistically foreseeable, with this or any other means, after 2020. This is important to keep in mind as supporters of more radical reforms mind find the proposal to be not ambitious enough. This may well be the case, however, taking into account the still massively divergent views of the Member States on the common EU vision, more radical proposals, at least from the present standpoint, do not seem to have a realistic possibility to already be put into practice in the next financial perspective.

Even though there seems to be an overwhelming consensus on the necessity for change, there are arguments that "sceptics" could use against the proposed approach. Firstly, while the proposal is straightforward, it still represents a rather severe departure from the present practices, which could give rise to fears whether the willingness for modification of budgetary procedures is strong enough and whether a consensus among the Member States and the Parliament can eventually be achieved at all under modified procedure. Such fears are easily comprehensible taking into account that, at first sight, the budgetary procedure does seem rather complicated and requires a set of additional decisions (division of expenditures between the two parts of the budget, agreement on the ex-ante allocation keys). Secondly, the proposal renders the net financial balances, and thus also the net contributions, fully transparent. Even though net balances have been the centre of negotiation focus of the Member States in the past, politicians might not have made such clear cases in public, hence the possibility of reserved political reaction, especially among the net payers. "Sceptical" approaches could additionally be conceived among the Member States that receive disproportionately large (financial) benefits from the EU budget relative to their prosperity, i.e. those countries that no not contribute as much as they should according to the fairness principle (according to the "net balance / GNI per capita" relationship, Ireland might be one such example). Finally, the proposed budgetary procedure would enable the introduction of new policies, it would at the same, however, invalidate the fundamental motif of (particular) Member States to defend (particular) policies which neither bring value added to the EU nor to the country in question, but have been defended purely due to the "jouste retour" negotiation tactics. Such a change could in turn provoke resistance from those interest groups that are the "beneficiaries" of the present rigidities in the EU budget (landowners in the case of Common Agricultural Policy might be one such example).

CONCLUSION

The paper analyses the decision-making efficiency of the EU, paying particular attention to the consequences of the rising number of Member States and the alleged inability of the EU to respond to new challenges. The heterogeneity of preferences due to enlargement is an often cited argument for the strengthened "federalisation" of the EU either in the direction of a significantly expanded majority voting system or stronger political integration. I have argued that the quantitative research usually used to analyse this topic is liable to overlook potentially crucial qualitative factors that have a much stronger impact on the efficiency of the decision-making in the EU than the "before-after" quantitative research designs.

It has been pointed out that a number of challenges that the EU is confronted with have asymmetric consequences for different parts of the Union, which in spite of the need for common response still necessitate a generally balanced policy-mix. Thus, contrary to the predominant view I argue that consensus is an asset and quality of the European decision-making, which should be cherished and preserved at least in the medium term. It has been furthermore established that time-efficiency in the decision-making of the enlarged Union has in fact not diminished, although it has changed in qualitative terms. Increased heterogeneity of preferences due to enlargement has certainly contributed to this; I argue, however, that there are two other mechanisms at work that contribute more strongly to the inefficient "horse-trading" in the EU. The first is the suboptimal and blurred division of responsibilities where, on the one hand, the EU is increasingly taking decisions on issues where no EU involvement is justified, while also introducing "coordination" mechanisms that reduce the transparency of the decision-making. The second inefficiency mechanism refers to policies that are or should be implemented on the EU level. In deciding on those, the Member States have distorted (financial) incentives – as a consequence policy-balance is not determined by the merit of the policies but by the Member States' net financial positions, which makes decision-making much more complex and notoriously inefficient.

By making use of the contributions of De la Fuente and Domenech, 2001, Begg 2005, Begg and Heinemann 2006 and Heinemann 2007, this paper offers a concrete and workable proposal for how the misgivings of the present budgetary and consequently decision-making procedure could be improved. The proposal simplifies the reform, makes the budgetary process more flexible for the decision makers, and thus hopefully also makes it politically more feasible. Furthermore, it places greater stress on the bottom-up principle while simultaneously establishing the right incentive mechanism for the Member States that should not just empower the EU to finance more of the "right policies", but also enable it to optimise the division of responsibilities between the EU and the Member States, thus also enabling more efficient decision-making in general. Our proposal provides a tool for a more significant reform of the budgetary structure in line with the asymmetric and symmetric challenges already posed in the medium term, i.e. for the Agenda 2014, without any detrimental effects on the solidarity principle and with a radically improved fairness principle in the EU finances.

The reforms above clearly do not represent an exhaustive list of the possible measures for improved decision-making. I do believe, however, that such a change would re-orient the focus of the decision-making onto the relevant issues and thus improve its efficiency much more than by moving away from the consensual decision-making. Furthermore, this example also shows that it is the qualitative and not quantitative factors that should come to the fore when discussing decision-making efficiency of the EU.

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