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

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A diagnosis is the least controversial part of nearly every proposal of the reform of the EU finances. When it comes to define solutions opinions starts to differ. The excellent paper by Alfonso Iozzo, Stefanno Micosi and Maria Teresa Salvemini may serve as confirmation of this general rule. It does not devote much of the analysis to the deficiencies of the current financial system of the EU. It proposes changes to the EU budget which are very interesting and which offer a good basis to rethink the purpose of EU finances. The paper tries to address long standing problems by the separation of functions of the EU budget. This is an appealing proposition. It is derived from the analysis that depending on the function played by the EU expenditures and their outcome one could expect the possibility of untying quarrels over different budget entries. This however ignores the underlying motivation of decision makers and exaggerates possibilities to frame disputes to better defined and generally smaller problems within each of the proposed parts of the EU budget.

Partition of the EU budget is made on the basis of the assumption that theory of fiscal federalism can be applied to explain the purpose of the EU budget. This theory is however much better adapted to explain financial arrangement of the far more closely related federal structures. The structuring public finances and the delivery public goods at the given level - local, regional, national, European – is intellectually appealing but not so easy to be applied in relation to the current situation in the EU. To make such restructuring possible the relationship between EU budget and national budgets (as well as the EU as political construction) should become radically different. The present EU is far from being a federalist entity. Thus the theory of fiscal federalism should be applied with sufficient moderation. It could be argued that proposals should not necessarily be fully realistic if authors are guided by perfection, idealism and theoretical considerations when suggesting a new construction.

In the paper proposals in their concrete forms seem to be a compromise between ideal shape of the EU budget – as seen by authors - and what is politically achievable. Intellectually a distinction between the chapter titled “Transfers between the member states” and the chapter “European public goods” is very attractive. When it is boiled down to proposed allocations of different budgetary titles it becomes quite clear that there is a blurred line of division between different items covered by the UE finances and therefore proposed allocation of EU expenditures between proposed parts is not consistent. If we assume that budgetary transfers between EU member states are justified they should have an undisputed form of solidarity payments whereas in practice they have the form of conditional payments related to some objective parameters (like crops etc.) or implementation of various EU policy measures and instruments. Inclusion of direct payments to farmers in this category is an extreme example of this inconsistency. Firstly, direct payments to farmers are rather transfers between individuals and not between countries. Secondly, national authorities of particular member states cannot change the rules governing these payments because these rules are part of the Common Agricultural Policy. So the question is to which extent the first proposed part of the budget can be understood as real transfers and to which extent it serves a function to assist implementation of the EU policies. If the execution of EU policies is helped by the EU budget it means that it serves delivering the European public goods, hence consistently it should be considered under the second proposed part of the budget. Furthermore, taking into account the fact that spending public money has also a territorial aspect one cannot ignore that some of the items allocated to the second part are benefiting only some of the regions and therefore can have similar impact as transfers. This is the major difficulty because within the budget discussions there has been a limited number of instances where arguments where used openly to allocate funds as pure transfers. It rather starts with the intention to define policies and instruments requiring EU funds which have additional or hidden motivations to bend rules in order to affect territorial distribution of money.

The authors assume that "benefits from the consumption of public goods cannot be meaningfully imputed to individual member states, give their nature as indivisible goods, whose benefits accrue to citizens and commercial operators regardless of individual consumption and residence. ….. Therefore in Chapter Two it would be meaningless to calculate net balances by member states." But practice is far from that. In numerous cases member states have argued using precisely calculated financial or economic impact of a given EU budgetary decision. Discussion concerning the "Galileo" project showed that member states were able to agree, only after ensuring "fair distribution" of individually calculated financial impact of this project and also after ensuring long term distribution between major stakeholders of any related economic activity. Similar preoccupations were evident in the process of finding a purpose to spend 5 billion Euros within European Recovery Plan. The intensity of disputes confirms that such decisions cannot be expected to be immune from considerations of the net balance position of every member state.

Proposed structure of the EU budget pays little attention to the fact that EU expenditures are not single way of delivery of the EU public goods. EU policies – which are the source of imminent EU public goods - are predominantly financed by the national budgets or their costs are paid by EU citizens. This is achieved by the EU rules, laws and regulations supported by the mixture of public funds coming from national and EU sources. However, even then member states when taking decisions concerning EU regulations (with no direct financial involvement of the EU budget) are calculating overall economic charge for them. Moreover they try to ensure some balance in expenditures incurred by the adopted EU regulatory framework or even request some form of compensation. The recently adopted climate and energy package shows that on the one hand redistribution of a fraction of the emission permits were considered as a form of transfers between EU member states. On the other hand rules related to carbon leakage and possibility of adding actions outside of the EU territory to the achieved emission reductions can be treated as balancing component of implementation costs for some member states. Hence adopting directives or regulations provokes member states to calculate the balance of costs and their territorial distribution. Therefore it is even more evident that any budgetary entry even related to financing evident and indivisible European public goods would also involve such calculations.

Again the example of the Climate and Energy Package is very interesting in this context. It establishes EU wide mechanism that impose (via the market) a charge on emissions of CO_2 which may reach level of tens of billions of Euro i.e. an amount possibly bigger than half of EU budget. These funds generated thanks to the EU defined mechanism will become part of national public finances and should in principle predominantly serve a purpose of investing in "green economy". It is therefore an example that EU legislation can create revenues for public finances and together with the definition of their purpose. But these public funds shall not be recycled via the EU budget and will not appear during budgetary debates. This suggests that analysis of the EU budget and therefore proposals of its reform should be considered in a wider context of other ways that EU impact on member states and their policies and budgets. Each member states looks at the totality of a balance between benefits and cost of EU integration and whenever is possible it tries to assure the equal burden sharing and/or positive net balance position.

The essence of the proposal is to avoid quarrels over excessive net budgetary position by a fragmentation of the EU budget. Such fragmentation, as the authors hope, would diminish the intensity of disputes. Smaller funds and smaller parts of the budget make the issue of ensuring national budgetary position less justified. But this could easily lead to greater frequency of such disputes over every small item within the EU budget. Maybe the solution lies in quite opposite proposition. Instead of separating particular items of the EU budget one should try to look at totality of public expenditures by EU and its member states. The aim should be to balance contributions to implement EU policies, to finance EU actions and instruments from whichever level of public finances (local, regional, national or EU).

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