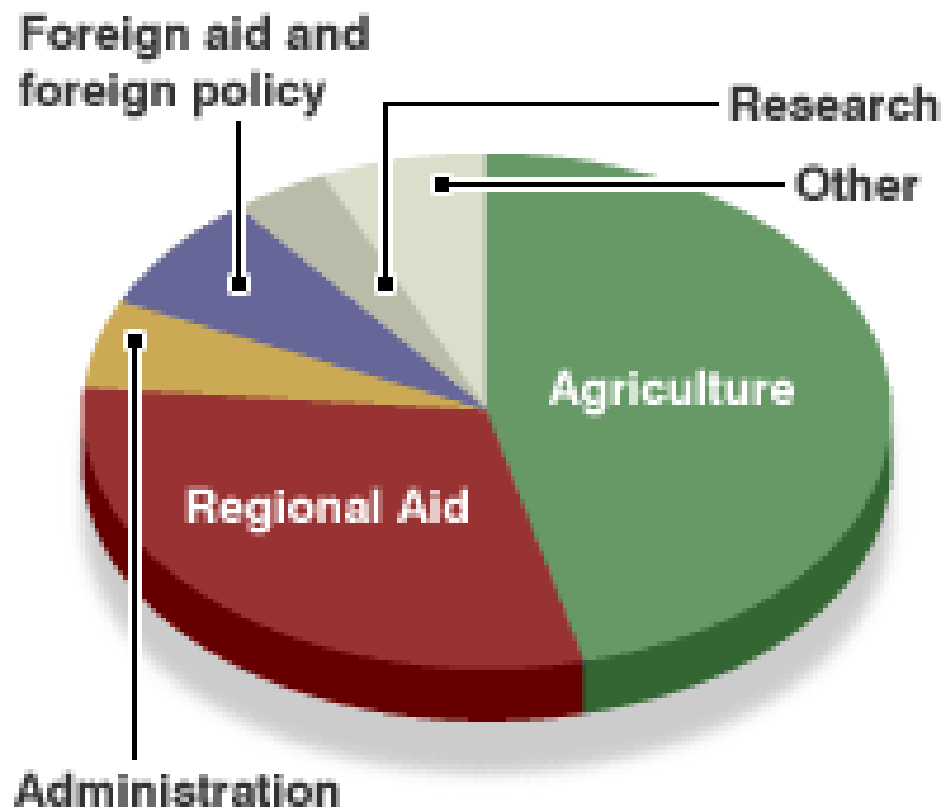




CPB Netherlands Bureau for Economic Policy Analysis

## The Value Added of the EU Budget: Subsidiarity and Effectiveness

- Arjan Lejour and Willem Molle (EUR)
- Joint CEPS-SIEPS Seminar:
- *The Next Long-Term Budget, 9 March 2011*



SOURCE: European Commission



## Two questions

- An assessment of justification of the EU involvement by using the subsidiarity principle as the key analytical tool.
  - fiscal federalism arguments
  - political economy and public choice
- An assessment of the effectiveness of the spending through the EU budget by checking the degree to which the EU has actually reached its goals.
  - additionality
  - output
- Main Sources:
  - ECORYS/CPB/IFO, 2008, A Study on EU spending.
  - Molle, 2011, European Economic Governance, Routledge, London.



## Definition subsidiarity (TFEU)

- *“In areas which do not fall within its exclusive competence the Union shall act only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather by reason of the scale or effects of the proposed action be better achieved at Union level”.*
- *Proportionality: “The content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties”.*



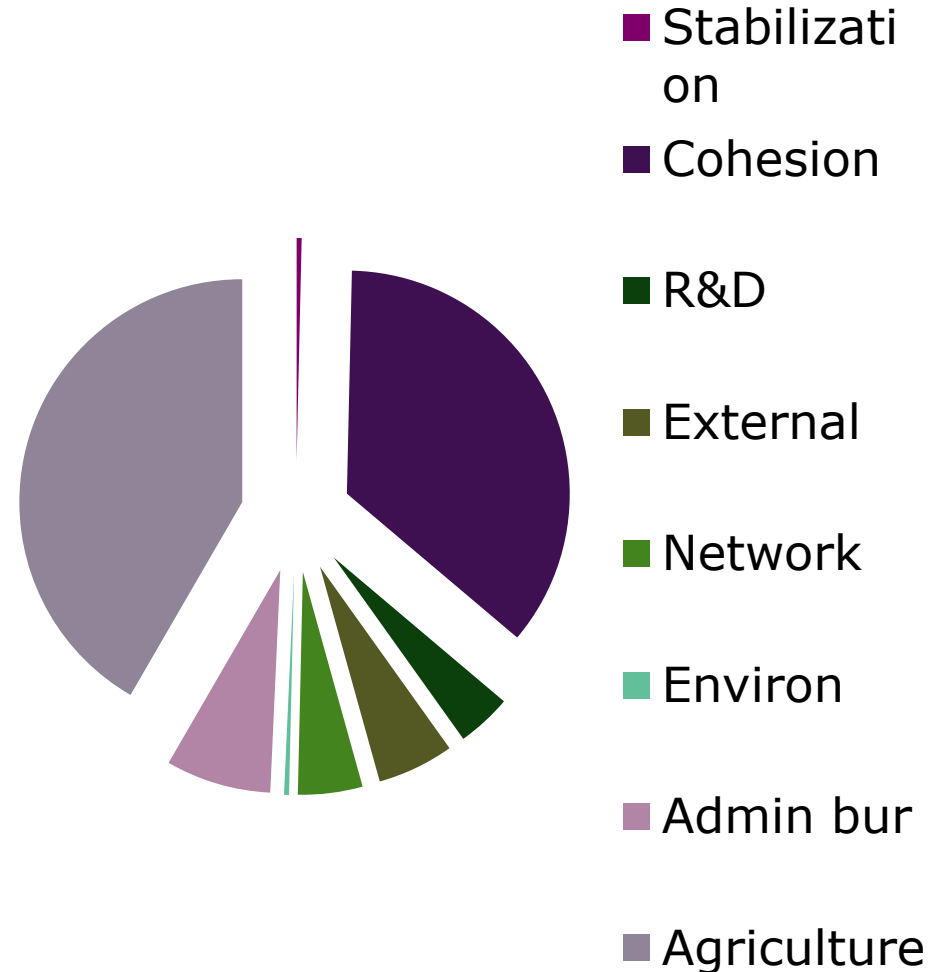
## Operationalization subsidiarity

<b>Theoretical foundation</b>	<b>Centralization</b>	<b>Decentralization</b>
Fiscal Federalism	Economies of scale Externalities	Heterogeneity of preferences Policy experimentation
Public choice Political economy	Limits to system competition Second best Complementarity	Self interest Common pool Credibility of cooperation



## EU commitments 2010

- Budget 126.6 billion, about 1% of GDP.
- National budgets on average 47% of GDP.
- EU budgets on cohesion, R&D, agriculture and external policies are more than 10% of total government spending.
  - additionaly.





## Functions of the budget

- *Allocation:*
  - impact in most policy fields is meagre
  - except agriculture
- *Stabilization:*
  - EU budget is not an instrument of macro-economic policy
  - budget is too small
- *Redistribution:*
  - Large expenses on regional and social policies
  - but redistributive power is limited compared to national budgets.



## Macro stabilization (fiscal)

- Common monetary policy (EMU countries).
- Complementarity with monetary policy.
- Dominant: diversity is important w.r.t. equity and allocation.
- Spillovers effects are not perceived as large in spite of complementarities with internal market.
- Public choice arguments plea for decentralization
  - rent-seeking more difficult, less fiscal illusion, competition between governments.
- Due to financial contagion, spillover effects are much larger,
- But size of EU budget is far too small
  - it could only create leverage for borrowing
  - only a supportive role of the EU.
- Stabilization role is still assigned to national governments.



## Smart growth with R&D and innovation

- Budget is large: 53.3 billion for the period 2007 -2013 (FP7).
- Normative arguments:
  - Economies of scale w.r.t. nearly all programmes.
  - In addition, spillovers w.r.t. Cooperation, IDEAS and People.
  - Diversity could be covered by substantial national budgets.
- Public choice arguments are not dominant.
- R&D funding to SMEs could also be financed by national governments (no spillovers).
  
- Conclusion: expansion of EU budget.





## Sustainable growth: environment

- EU budget for environment is very small:
  - mainly regulation which matters
  - additional financing in regional and R&D budget.
- Economies of scale and spillovers prevail for climate change and biodiversity.
  - does not matter for environmental health and quality of life.
- Economies of scale in R&D for environmental purposes.
- Substantial more R&D is needed for environment and energy security.
- Conclusion: expansion of EU budget.



## Sustainable growth: agriculture

- Large, but shrinking budget (in relative terms):
  - income support and market intervention: 81% of budget
  - rural development: 19%.
- Spending on income support is path dependent.
- Fiscal federalism arguments plea for decentralization.
- Market policies should be centralized, if these are necessary at all.
- Common pool arguments plea for decentralized rural development policies.
  
- Conclusion: mitigate EU spending on agriculture substantially.



## External policies

- Main part of budget is used for development aid, ENP and accession.
- ENP and accession policies:
  - substantial spill-over effects (see internal market)
  - economies of scale do prevail.
  - heterogeneity increases, but ENP is country-specific.
- Development aid:
  - economies of scale
  - positive externalities
  - preferences diverge, but can be dealt with using national budgets.
- Conclusion: size of budget should be increased.



## Effectiveness

- Measurement by output/goals is relatively easy.
- The measurement of outcome performance is hard:
  - budget does not work in isolation.
- Effectiveness for the various budget categories:
  - Stabilization budget is too small for effective actions.
  - R&D seems to be effective given the limited resources, but targets are not met.
  - Environment: depends of effectiveness on regulation and coordination which is hard to judge.
  - Agriculture: income support is not effective, because it is not conditioned.
  - Effectiveness of development aid is very meagre.



## Recommendations

- Doubling resources on stabilization, R&D, environment and external policies:
  - would increase additionality.
- Less spending on regional competitiveness and direct income payments.
- Mitigate spending on other categories:
  - low additonality and thus low effectiveness.
- EU budget on R&D, environment and external policies deliver long-term benefits:
  - plea for more drastic changes in future budgets
  - R&D and innovation should become the largest budget category.
- Coordination of national and EU governance is fundamental to generate a large value added of EU budget and policies.