Back to basic with the EU budget

It is often argued that the EU budget is largely the product of successive inter-governmental side-payments with little economic rationale. It is small and fairly inflexible, with expenditures dominated by two large redistributive policies - the Common Agricultural Policy (CAP) and the Structural and Cohesion Funds - which together will still account for almost three quarters of total expenses by 2013. But, although the last round of negotiations for the Financial Programme 2007-2013 was disappointing and brought about little change, there was one hopeful outcome, namely, the agreement to carry out a through review of the EU finances by 2008/2009. The European Commission has now officially launched this review process with the recent publication of its consultation paper “Reforming the Budget, Changing Europe”. Its main message is clear: the EU needs to look forward.

The Commission does well in stressing that the name of the game when it comes to the EU budget is change. Globalization, technology, the demographic transition, climate change, energy, migration, internal and external security, as well as the increasing income disparities within the EU, are all noted in the report to be key elements in determining the course of EU policies in the future. Nonetheless, it is important to keep in mind that it is just a very first step towards meaningful reform.

Many of the key issues related to the reform of the EU budget have been long established. First, there is the general conflict between Member States who are net contributors and net beneficiaries in terms of the budget size. This tension arises, for the most part, from the skewed distribution of expenditures, and has lead to a number of adjustments, such as the UK rebate. The revenue structure of the EU budget has also come into question, especially in terms of the need to move towards a European tax instead of relying on national treasuries. All of these issues are markedly compounded by the Eastern Enlargement and the associated increase in the Community’s heterogeneity in levels of development, economic structure and preferences.

Against this background, however, what remain less clear are the different policy alternatives available and the trade-offs implied by each option. Mapping policy choices requires a though assessment of both current and potential expenditure programmes. All policies need to be assessed and proven to have value added for the Community. And this necessarily means reviewing the performance of all EU programs, especially those that take up a significant proportion of the funds. The current review process is a great opportunity, but one that has to start with a clean slate.

The Commission does publish annually a Cohesion Report intended to assess the impact of both cohesion and structural funds, and has started a “health check” of the agricultural policy as well. Understanding the impact of policies on key outcomes, such as growth and inequality, is fundamental for designing expenditure policies. But it has to be done right, of course.

Let’s take the case of cohesion policy as an illustration. The Commission appears to take as given the effectiveness of cohesion and structural funds in reducing cross-country and regional disparities, but the existing evidence is weak at best. The 4th Cohesion Report, issued in May 2007, argues that the cohesion policy of the Union has a large and positive impact on growth in recipient countries. Even if one accepts these estimates– and the multiple assumptions embedded in the models used – this exercise says nothing about the alternative use of those resources. At the end of the day, EU funds do not fall from the sky. The relevant question is whether cohesion funds are the most efficient redistribution instrument available. Nobody can really answer this question today.

In terms of regional convergence, the story is still frailer. For starters, there is no comprehensive database – at least not readily accessible - of the use of structural funds at the regional level in the EU. The information needed is spread among local authorities at a very decentralized level. It needs to be aggregated to allow for a full review of the policy. This lack of ex-post centralization of information is shocking since this means that there is no appropriate monitoring and evaluation of the use of these funds. Without this information, it is clearly not possible to carry out a causal impact analysis of regional funds. As a result, claims about the effect of structural funds on regional disparities are based on simple correlations.

A suitable evaluation of the use of regional funds should provide answers to three key questions. First, what is the economic rationale behind the Community’ expense i.e. whether the EU is the level at which regional redistribution is to be carried out. Second, whether the goal is achieved by the policy. And third, whether there are other more efficient mechanisms to reach the goals set. While the tools exist to have an informed discussion on the first issue (even though agreement is elusive), the development of instruments to be able to respond to the last two enquiries is still on its early stages. The same principles would apply to the evaluation of other EU policies where it is possible to identify the beneficiaries.

The truth is that nobody knows what the impact of EU expenditure is, and this is discouraging moving ahead in the reform process. Now that the formal discussion on EU budgetary reform has been ignited, the Commission needs to get back to the drawing board and think hard about policy evaluation design. This is the first step in improving the effectiveness and efficiency of budget delivery, one of the central questions put forward in the Commission's paper.

"Reforming the Budget, Changing Europe" is successful in stressing the need for Europe to adopt a budget that allows it to successfully take on the new challenges of this century, but there is need to go back to fundamentals. Appropriate policy evaluation is the natural place to begin. An independent and rigorous evaluation of EU policies, however, is currently not possible with the existing data and institutional limitations. Going forward often implies taking a step – or two – back.

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